THE ECONOMIC DEVELOPMENT OF LATIN AMERICA

and its principal problems

ECONOMIC COMMISSION
FOR LATIN AMERICA

UNITED NATIONS
DEPARTMENT OF ECONOMIC AFFAIRS
Lake Success, New York, 1950

E/CN.12/89/Rev. 1*
27 April 1950
Original text: Spanish

UNITED NATIONS PUBLICATION

Sales No.: 50. II.G. 2

Price: $U.S. 0.50
(or equivalent in other currencies)

* Original document reproduced in Santiago, Chile.

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Letter of Transmittal

Santiago, Chile

9 October 1949

Sir,

I have the honour to transmit to you herewith an essay entitled "The Economic Development of Latin America and its principal problems", by Professor Raul Prebisch.

In creating the Economic Commission for Latin America, the Economic and Social Council stated that one of its main purposes would be to "make or sponsor . . . investigations and studies of economic and technological problems and developments within territories of Latin America . . .".

Having regard to the importance of fostering research along these lines, and in agreement with the Assistant Secretary-General in charge of the Department of Economic Affairs, Mr. David Owen, the undersigned Executive Secretary has sponsored the preparation of a paper on "The Economic Development of Latin America and its principal problems", which has been written by Professor Raul Prebisch.

It is hoped that its publication may arouse further interest in economic investigations in the Latin-American countries and that it will prompt the writing of similar works which aim at finding a solution to the basic problems confronting Latin America, the correct presentation of which has become a matter of immediate concern.

I have the honour to be, Sir,
Your obedient servant,

GUSTAVO MARTÍNEZ CABAÑAS
Executive Secretary

MR. TRYGVE LIE
Secretary-General of the
United Nations
Lake Success, New York

I. Introduction

In Latin America, reality is undermining the out-dated schema of the international division of labour, which achieved great importance in the nineteenth century and, as a theoretical concept, continued to exert considerable influence until very recently.

Under that schema, the specific task that fell to Latin America, as part of the periphery of the world economic system, was that of producing food and raw materials for the great industrial centres.

There was no place within it for the industrialization of the new countries. It is nevertheless being forced upon them by events. Two world wars in a single generation and a great economic crisis between them have shown the Latin-American countries their opportunities, clearly pointing the way to industrial activity.

The academic discussion, however, is far from ended. In economics, ideologies usually tend either to lag behind events or to outlive them. It is true that the reasoning on the economic advantages of the international division of labour is theoretically sound, but it is usually forgotten that it is based upon an assumption which has been conclusively proved false by facts. According to this assumption, the benefits of technical progress tend to be distributed alike over the whole community, either by the lowering of prices or the corresponding raising of incomes. The countries producing raw materials obtain their share of these benefits through international exchange, and therefore have no need to industrialize. If they were to do so, their lesser efficiency would result in their losing the conventional advantages of such exchange.

The flaw in this assumption is that of generalizing from the particular. If by "the community" only the great industrial countries are meant, it is indeed true that the benefits of technical progress are gradually distributed among all social groups and classes. If, however, the concept of the community is extended to include the periphery of the world economy, a serious error is implicit in the generalization. The enormous benefits that derive from increased productivity have not reached the periphery in a measure comparable to that obtained by the peoples of the great industrial countries. Hence, the outstanding differences between the standards of living of the masses of the former and the latter and the manifest discrepancies between their respective abilities to accumulate capital, since the margin of saving depends primarily on increased productivity.

Thus there exists an obvious disequilibrium, a fact which, whatever its explanation or justification, destroys the basic premise underlying the schema of the international division of labour.

Hence, the fundamental significance of the industrialization of the new countries. Industrialization is not an end in itself, but the principal means at the disposal of those countries of obtaining a share of the benefits of technical progress and of progressively raising the standard of living of the masses.

The Latin-American countries are thus faced with an immense general problem, embracing a series of minor ones which must be defined before embarking on the long task of research and practical measures which will be necessary if there is a firm intention to solve the problems.

It would be premature, in this initial report, to draw conclusions that would have only the doubtful value of an improvization. Admittedly much remains to be done in the Latin-American countries, both in learning the facts and in their proper theoretical interpretation. Though many of the problems of these countries are similar, no common effort has ever been made even to examine and elucidate them. It is not surprising, therefore, that the studies published on the economy of Latin-American countries often reflect the points of view or the experience of the great centres of world economy. Those studies cannot be expected to solve problems of direct concern to Latin America. The case of the Latin-American countries must therefore be presented clearly, so that their interests, aspirations and opportunities, bearing in mind, of course, the individual differences and characteristics, may be adequately integrated within the general framework of international economic co-operation.

The task ahead is thus considerable and the responsibility heavy. To deal with it methodically, it would be necessary to begin with a preliminary examination of the principal problems as a whole, at the same time bringing out certain general considerations suggested by direct contact with the economic life of Latin America. Such is the purpose of this report.

The industrialization of Latin America is not incompatible with the efficient development of primary production. On the contrary, the availability of the best capital equipment and the prompt adoption of new techniques are essential if the development of industry is to fulfil the social objective of raising the standard of living. The same is true of the mechanization of agriculture. Primary products must be exported to allow for the importation of the considerable quantity of capital goods needed.

The more active Latin America's foreign trade, the greater the possibility of increasing productivity by means of intensive capital formation. The solution does not lie in growth at the expense of foreign trade, but in knowing how to extract, from continually growing foreign trade, the elements that will promote economic development.

If reasoning does not suffice to convince us of the close tie between economic development and foreign trade, a few facts relating to the situa-

tion today will make it evident. The economic activity and level of employment in the majority of the Latin-American countries are considerably higher than before the war. This high level of employment entails increased imports of consumer goods, both non-durable and durable, besides those of raw materials and capital goods, and very often exports are insufficient to provide for them.

This is evident in the case of imports and other items payable in dollars. There are already well-known cases of scarcity of that currency in certain countries, despite the fact that the amount of dollars supplied by the United States to the rest of the world in payment of its own imports was considerable. In relation to its national income, however, the import coefficient of the United States has, after a persistent decline, arrived at a very low level (not over 3 per cent). It is, therefore, not surprising that, notwithstanding the high income level of the United States, the dollar resources thus made available to the Latin-American countries seem insufficient to pay for the imports needed for their intensive development.

It is true that as European economy recovers, trade with that continent can profitably be increased, but Europe will not supply Latin America with more dollars unless the United States increases its import coefficient for European goods.

This, then, is the core of the problem. It is obvious that if the abovementioned coefficient is not raised, Latin America will be compelled to divert its purchases from the United States to those countries which provide the exchange to pay for them. Such a solution is certainly very dubious, since it often means the purchase of more expensive or unsuitable goods.

It would be deplorable to fall back on measures of that kind when a basic solution might be found. It is sometimes thought that, by reason of the enormous productive capacity of the United States, that country could not increase its import coefficient for the purpose of providing the basic solution to this world problem. Such a conclusion cannot be substantiated without a prior analysis of the factors that have caused the United States steadily to reduce its import coefficient. These factors are aggravated by unemployment, but can be overcome when it does not exist. One can understand that it is of vital importance, both to Latin America and the rest of the world, that the United States achieve its aim of maintaining a high level of employment.

It cannot be denied that the economic development of certain Latin-American countries and their rapid assimilation of modern technology, in so far as they can utilize it, depend to a very large extent upon foreign investment. The implications involved render the problem far from simple. The negative factors include the failure to meet foreign financial commitments during the great depression of the nineteen thirties, a failure which, it is generally agreed, must not be allowed to happen

again. Fundamentally the problem is the same as that referred to in the preceding paragraph. The servicing of these foreign investments, unless new investments are made, must be paid for by means of exports in the same currency and, if these do not show a corresponding increase, in time the same difficulties will arise again. They will be the greater if exports fall violently. The question thus arises whether, pending that basic solution, it would not be wiser to direct investments toward such productive activities as would, through direct or indirect reduction of dollar imports, permit the regular servicing of foreign obligations.

Here one must beware of dogmatic generalizations. To assume that the meeting of foreign commitments and the proper functioning of the monetary system depend upon nothing more than a decision to obey certain rules of the game is to fall into an error involving serious consequences. Even when the gold standard was in operation in the great centres, the countries of the Latin-American periphery had great difficulty in maintaining it, and their monetary troubles frequently provoked condemnation from abroad. The more recent experiences of the large countries have brought a better understanding of some aspects of the situation. Great Britain, between the two wars, encountered difficulties somewhat similar to those which arose and continue to arise in the Latin-American countries, which have never taken kindly to the rigidity of the gold standard. That experience doubtless helps to bring about a better understanding of the phenomena of the periphery.

The gold standard has ceased to function, as in the past, and the management of currency has become even more complex in the periphery. Can all these complications be overcome by a strict application of sound rules of monetary behaviour? Sound rules for these countries are still in the making. Here there arises another vital problem; that of utilizing individual and collective experience to find a means of harmoniously fitting monetary action into a policy of regular and intensive economic development.

Let this not be interpreted as meaning that the classic teachings are of no value. If they do not provide positive rules, they at least show what cannot be done without impairing the stability of the currency. The extremes to which inflation has gone in Latin America show that monetary policy was not based upon these teachings, since some of the larger Latin-American countries increased circulation to a greater extent than did those countries which had to meet enormous war expenditure.

There is yet another aspect of the problem of dollar shortage. It is true that, as already stated, a high level of employment increases imports. But it is also a fact that an excessive monetary expansion has often unduly increased the pressure on the balance of payments, thus leading to the use of foreign exchange for purposes not always compatible with economic development.

These facts must be taken into account in an objective analysis of the effects of the inflationary increase on the process of capitalization. It must, however, be admitted that, in most of the Latin-American countries, voluntary savings are not sufficient to cover the most urgent capital needs. In any case, monetary expansion does not bring about an increase in the foreign exchange reserves necessary for the importation of capital goods; it merely redistributes income. It must now be determined whether it has led to a more active capital formation.

The point is a decisive one. The raising of the standard of living of the masses ultimately depends on the existence of a considerable amount of capital per man employed in industry, transport and primary production, and on the ability to use it well.

Consequently, the Latin-American countries need to accumulate an enormous amount of capital. Several have already shown their capacity to save to the extent of being able to finance a large part of their industrial investments through their own efforts. Even in this case, which is exceptional, capital formation has to overcome a strong tendency towards certain types of consumption which are often incompatible with intensive capitalization.

Nevertheless, it does not appear essential to restrict the individual consumption of the bulk of the population, which, on the whole, is too low, in order to accumulate the capital required for industrialization and for the technical improvement of agriculture. An immediate increase in productivity per man could be brought about by well-directed foreign investments added to present savings. Once this initial improvement has been accomplished, a considerable part of the increased production can be devoted to capital formation rather than to inopportune consumption.

How are sufficient increases in productivity to be achieved? The experience of recent years is instructive. With some exceptions, the rise in employment necessitated by industrial development was made possible by the use of men whom technical progress had displaced from primary production and other occupations, especially certain comparatively poorly paid types of personal services, and by the employment of women. The industrial employment of the unemployed, or ill-employed, has thus meant a considerable improvement in productivity and, consequently, where other factors have not brought about a general lowering of productive efficiency, a net increase in national income.

The great scope for technical progress in the field of primary production, even in those countries where it has already been considerable, together with the perfecting of existing industries, could contribute, to national income, a net increase that would provide an ever-increasing margin of saving.

All this, however, especially in so far as it is desired to reduce the need for foreign investments, presupposes a far greater initial capitalization than is usually possible with the type of consumption of certain sectors

of the community, or the high proportion of national income absorbed, in some countries, by fiscal expenditure, which makes no direct or indirect contribution to national productivity.

It is, in fact, a demonstration of the latent conflict existing in these countries between the desire to assimilate, quickly, ways of life which the technically more advanced countries adopted step by step as their productivity increased, and the need for capitalization without which this increase in productivity could not be achieved.

For the very reason that capital is scarce, and the need for it great, its use should be subjected to a strict standard of efficacy which has not been easy to maintain, especially where industries have developed to meet an emergency. There is, however, still time to correct certain deviations and, above all, to avoid them in the future.

In order to achieve this, the purpose of industrialization must be clearly defined. If industrialization is considered to be the means of attaining an autarchic ideal in which economic considerations are of secondary importance, any industry that can produce substitutes for imports is justifiable. If, however, the aim is to increase the measurable well-being of the masses, the limits beyond which more intensive industrialization might mean a decrease in productivity must be borne in mind.

Formerly, before the great depression, development in the Latin-American countries was stimulated from abroad by the constant increase of exports. There is no reason to suppose, at least at present, that this will again occur to the same extent, except under very exceptional circumstances. These countries no longer have an alternative between vigorous growth along those lines and internal expansion through industrialization. Industrialization has become the most important means of expansion.

This does not mean, however, that primary exports must be sacrificed to further industrial development. Exports not only provide the foreign exchange with which to buy the imports necessary for economic development, but their value usually includes a high proportion of land rent, which does not involve any collective cost. If productivity in agriculture can be increased by technical progress and if, at the same time, real wages can be raised by industrialization and adequate social legislation, the disequilibrium between incomes at the centres and the periphery can gradually be corrected without detriment to that essential economic activity.

This is one of the limits of industrialization which must be carefully considered in plans of development. Another concerns the optimum size of industrial enterprises. It is generally found in Latin-American countries that the same industries are being attempted on both sides of the same frontier. This tends to diminish productive efficiency and so militates against fulfilling the social task to be accomplished. The defect is a serious one, which the nineteenth century was able to attenuate con-

siderably. When Great Britain proved, with facts, the advantages of industry, other countries followed suit. Industrial development, however, spurred by active competition, tended towards certain characteristic types of specialization which encouraged profitable trade between the various countries. Specialization furthered technical progress and the latter made possible higher incomes. Here, unlike the case of industrial countries by comparison with those producing primary products, the classic advantages of the division of labour between countries that are equal, or nearly so, followed.

The possibility of losing a considerable proportion of the benefits of technical progress through an excessive division of markets thus constitutes another factor limiting the industrial expansion of these countries. Far from being unsurmountable, however, it is a factor which could be removed with mutual benefit by a wise policy of economic interdependence.

Anti-cyclical policies must be included in any programmes of economic development if there is to be an attempt, from a social point of view, to raise real income. The spread of the cyclical fluctuations of the large centres to the Latin-American periphery means a considerable loss of income to these countries. If this could be avoided, it would simplify the problem of capital formation. Attempts have been made to evolve an anti-cyclical policy, but it must be admitted that, as yet, but little light has been thrown on this subject. Furthermore, the present dwindling of metallic reserves of several countries means that, in the event of a recession originating abroad, they would not only be without a plan of defense but would lack means of their own to carry out the measures demanded by the circumstances.

The principal problems having been set forth in this first part of the report, the following sections will be devoted to some of their outstanding aspects, which must be discussed both on account of their intrinsic importance and of the need for carrying out systematic research on them.[1]

[1] The obstacles in the way of carrying out such a task in Latin America are well known. The greatest difficulty is perhaps the small number of economists capable of an original approach to the specific problems of these countries. For various reasons, it has not been possible to supply the lack by training an adequate number of young men of high intellectual calibre. Considerable progress has been made by sending them to the great European and American universities, but this is not sufficient. One of the most conspicuous deficiencies of general economic theory, from the point of view of the periphery, is its false sense of universality.

It could hardly be expected that the economists of the great countries, absorbed by serious problems of their own, should devote preferential attention to a study of those of Latin America. The study of Latin America's economic life is primarily the concern of its own economists. Only if this regional economy can be explained rationally and with scientific objectivity, can effective proposals for practical action be achieved.

It must not be thought, however, that this desire springs from an exclusive individualism. On the contrary, Latin-American economists can only accomplish it on the basis of a sound knowledge of the theories expounded in the great countries with their wealth of universal truths. An intelligent knowledge of the ideas of others must not be confused with that mental subjection to them from which we are slowly learning to free ourselves.

II. The advantage of technical progress and the countries of the periphery

It was stated in the preceding section that the advantages of technical progress have been mainly concentrated in the industrial centres and have not directly extended to the countries making up the periphery of the world's economic system. The increased productivity of the industrial countries certainly stimulated the demand for primary products and thus constituted a dynamic factor of the utmost importance in the development of Latin America. That, however, is distinct from the question discussed below.

Speaking generally, technical progress seems to have been greater in industry than in the primary production of peripheral countries, as was pointed out in a recent study on price relations.[1] Consequently, if prices had been reduced in proportion to increasing productivity, the reduction should have been less in the case of primary products than in that of manufactures, so that as the disparity between productivities increased, the price relationship between the two should have shown a steady improvement in favour of the countries of the periphery.

Had this happened, the phenomenon would have been of profound significance. The countries of the periphery would have benefited from the fall in price of finished industrial products to the same extent as the countries of the centre. The benefits of technical progress would thus have been distributed alike throughout the world, in accordance with the implicit premise of the schema of the international division of labour, and Latin America would have had no economic advantage in industrializing. On the contrary, the region would have suffered a definite loss, until it had achieved the same productive efficiency as the industrial countries.

The above supposition is not borne out by the facts. As can be seen in the indexes of table 1, the price relation turned steadily against primary production from the 1870's until the Second World War. It is regrettable that the price indexes do not reflect the differences in quality of finished products. For this reason, it was not possible to take them into account in these considerations. With the same amount of primary products, only 63 per cent of the finished manufactures which could be bought in the 1860's were to be had in the 1930's; in other words, an average of 58.6 per cent more primary products was needed to buy the same amount of

[1] "Post War Price Relations in Trade Between Under-developed and Industrialized Countries", document E/CN.1/Sub.3/W.5.

finished manufactures.[2] The price relation, therefore, moved against the periphery, contrary to what should have happened had prices fallen as costs decreased as a result of higher productivity.

TABLE 1

Ratio of prices of primary commodities to those of manufactured goods (average import and export prices, according to data of the Board of trade)

Base: 1876-80 = 100

Periods	*Amount of finished products obtainable for a given quantity of primary commodities*
1876-80	100
1881-85	102.4
1886-90	96.3
1891-95	90.1
1896-1900	87.1
1901-05	84.6
1906-10	85.8
1911-13	85.8
—	—
1921-25	67.3
1926-30	73.3
1931-35	62.0
1936-38	64.1
—	—
1946-47	68.7

Source: "Post War Price Relations in Trade Between Under-developed and Industrialized Countries", document E/CN.1/Sub.3/W.5, 23 February 1949.

During the expansion of the last war, as in the case of all cyclical expansions, the relation moved in favour of primary products. Now, however, although there has not been a recession, a typical readjustment is taking place, with the result that prices of primary products are losing their former advantage.

The pointing out of this disparity between prices does not imply passing judgment regarding its significance from other points of view. It could be argued, on grounds of equity, that the countries which strove to achieve a high degree of technical efficiency were in no way obliged to share its fruits with the rest of the world. Had they done so, they would not have reached their enormous capacity to save, without which it might well be asked whether technical progress would have achieved the intense rhythm which characterizes capitalist development. In any case the productive technique exists and is at the disposal of those with

[2] According to the report already quoted. The figures for the thirties go only as far as 1938 inclusive. The data given are the Board of Trade's average price indexes for British imports and exports representative of world prices for raw materials and manufactured goods respectively.

the capacity and perseverance to assimilate it and increase their own productivity. All that, however, is outside the scope of this report. The purpose is to emphasize a fact which, despite its many implications, is not usually given the importance it deserves when the significance of the industrialization of the peripheral countries is discussed.

Simple reasoning on the phenomenon in question brings us to the following considerations:

First. Prices have not fallen concomitantly with technical progress, since, while on the one hand, costs tended to decrease as a result of higher productivity, on the other, the income of entrepreneurs and productive factors increased. When income increased more than productivity, prices rose instead of falling.

Second. Had the rise in income, in the industrial centres and the periphery, been proportionate to the increase in their respective productivity, the price relation between primary and manufactured products would have been the same as if prices had fallen in strict proportion to productivity. Given the higher productivity of industry, the price relation would have moved in favour of the primary products.

Third. Since, as we have seen, the ratio actually moved against primary products in the period between the 1870's and the 1930's, it is evident that in the centre the income of entrepreneurs and of productive factors increased relatively more than productivity, whereas in the periphery the increase in income was less than that in productivity.

In other words, while the centres kept the whole benefit of the technical development of their industries, the peripheral countries transferred to them a share of the fruits of their own technical progress.[3]

[3] "Post War Price Relations in Trade between Under-developed and Industrialized Countries", document E/CN.1/Sub.3/W.5, pp. 115-116:

"A long-term deterioration in terms of trade, such as has been found to obtain for primary producers over a long period, may be an effect of differences in the rate of increase in productivity in the production of primary commodities and manufactured articles, respectively. If we can assume that the deteriorating terms of trade for under-developed countries reflect a more rapid increase of productivity in primary commodities than of manufactured goods, the effect of worsened terms of trade would, of course, be less serious. It would merely mean that, to the extent that primary commodities are being exported, the effects of increased productivity are being passed on to the buyers of primary articles in the more industrialized countries. Although statistical data on differential rates of increase in productivity of primary production in under-developed countries, and production of manufactured articles in industrialized countries, are almost entirely lacking, this explanation of the long-term changes in terms of trade which were observed in this study may be dismissed. There is little doubt that productivity increased faster in the industrialized countries than primary production in under-developed countries. This is evidenced by the more rapid rise in standards of living in industrialized countries during the long period covered, from 1870 to the present day. Hence, the changes observed in terms of trade do not mean that increased productivity in primary production was passed on to industrialized countries; on the contrary, they mean that the under-developed countries maintained, in the prices which they paid for their imported manufactures relative to those which they obtained for their own primary products, a rising standard of living in the industrialized countries, without receiving, in the price of their own products, a corresponding equivalent contribution towards their own standards of living."

Before explaining the reason for this phenomenon, which is so important to Latin America, it would be well to consider how the effects of increased productivity are transmitted.

For this purpose, an illustrative example is presented in table 2, in which it is assumed that the indexes of productivity, per man, are greater in industry than in primary production. For the sake of simplification, both are supposed to make an equal contribution to the finished product.

TABLE 2

Illustration of the distribution of the benefits of technical progress between the centre and the periphery

	Primary production (1)	Industrial production (2)	Total production[a] (3)	Ratio $\frac{(1)}{(3)} \times 100$	Ratio $\frac{(2)}{(3)} \times 100$
Assumption: Productivity increases in accordance with the following indexes:	100	100	100	—	—
	120	160	140	—	—
First case: Costs decrease as productivity rises and prices decrease with costs, without any rise in income:	100	100 [b]	100	100	100
	83.3	62.5[b]	71.4	116.7	87.5
Second case: Costs decrease as in the first case, but income increases as follows:	100	100	100	100	100
	120	180	150	80	120
Changes in prices following the increase in income:	100	100 [b]	100	100	100
	99.9	112.5[b]	107.1	93.3	105

[a] Figures relate to the finished products. See explanation on page 18.
[b] Part of the price representing value added by the manufacturing process.

It has been assumed in the first case that, with an increase in productivity, from 100 to 120 in agriculture and from 100 to 160 in industry, incomes of entrepreneurs and productive factors do not rise, but costs fall. If prices are reduced *pari passu* with costs, the decline in the price of primary products is less than that in the case of manufactured goods, as is shown by the corresponding indexes. Consequently, the ratio between the two moves, in favour of the primary products, from 100 to 116.7.

This is precisely the ratio that would have allowed the increase in final production to be shared equally by the primary producers and the industrial centres. In fact, if there is an increase in primary productivity

from 100 to 120, and if, as has just been seen, 100 primary products can now be exchanged for 116.7 manufactured articles, it means that primary producers can now obtain 140 instead of 100 of those products, or, in other words, that the increase has been the same as in the case of final production, an increase obviously obtained by the industrial producers also.

There is a marked difference in these results when, in the second case, incomes are altered. It is assumed that, in industry, the increase in income is greater than the increase in productivity and that, in primary production, both increases are equal. As a result, the price ratio moves against primary production, from 100 to 93.3, so that primary products, despite the increase in productivity from 100 to 120, can buy only 112.0 final products, as against 100 previously. On the other hand, a similar calculation shows that industrial producers can now obtain 168 final products, as compared with the 100 they bought before.

It should be noted that, whereas the primary producers can increase their acquisitions of final products less than they increase productivity, industrial producers benefit more than they should in relation to the increase in their productivity.

It follows, logically, that if the increase in income in primary production had been assumed to be less than, instead of equal to, the increase in productivity, the price ratio would have dropped still further against the primary producers.

The deterioration of 36.5 per cent in the price ratio between the eighteen seventies and the nineteen thirties suggests the possibility of a phenomenon of that kind.

In short, if, in spite of greater technical progress in industry than in primary production, the price relation has moved against the latter instead of in its favour, it would seem that the average income, *per capita*, has risen more in industrial centres than in the producer countries of the periphery.

The existence of this phenomenon cannot be understood, except in relation to trade cycles and the way in which they occur in the centres and at the periphery, since the cycle is the characteristic form of growth of capitalist economy, and increased productivity is one of the main factors of that growth.

In the cyclical process of the centres, there is a continuous inequality between the aggregate demand and supply of finished consumer goods. The former is greater than the latter in the upswing and lower in the downswing.

The magnitude of profits and their variations are closely bound up with this disparity. Profits rise during the upswing, thus tending to curtail excess demand by raising prices; they fall during the downswing,

tending, in that case, to counteract the effect of excess supply by lowering prices.

As prices rise, profits are transferred from the entrepreneurs at the centre to the primary producers of the periphery. The greater the competition and the longer the time required to increase primary production in relation to the time needed for the other stages of production, and the smaller the stocks, the greater the proportion of profits transferred to the periphery. Hence follows a typical characteristic of the cyclical upswing: prices of primary products tend to rise more sharply than those of finished goods, by reason of the high proportion of profits transferred to the periphery.

If this be so, what is the explanation of the fact that, with the passage of time and throughout the cycles, income has increased more at the centre than at the periphery?

There is no contradiction whatsoever between the two phenomena. The prices of primary products rise more rapidly than industrial prices in the upswing, but also they fall more in the downswing, so that in the course of the cycles the gap between prices of the two is progressively widened.

Let us now look at the explanations of this inequality in the cyclical movement of prices. It was seen that profits rise in the upswing and decrease in the downswing, thus tending to offset the disparity between demand and supply. If profits could fall in the same way in which they rose, there would be no reason whatsoever for this unequal movement. It occurs precisely because they cannot fall in that way.

The reason is very simple. During the upswing, part of the profits are absorbed by an increase in wages, occasioned by competition between entrepreneurs and by the pressure of trade unions. When profits have to be reduced during the downswing, the part that had been absorbed by wage increases loses its fluidity, at the centre, by reason of the well-known resistance to a lowering of wages. The pressure then moves toward the periphery, with greater force than would be the case if, by reason of the limitations of competition, wages and profits in the centre were not rigid. The less that income can contract at the centre, the more it must do so at the periphery.

The characteristic lack of organization among the workers employed in primary production prevents them from obtaining wage increases comparable to those of the industrial countries and from maintaining the increases to the same extent. The reduction of income—whether profits or wages—is therefore less difficult at the periphery.

Even if there existed as great a rigidity at the periphery as at the centre, it would merely increase the pressure of the latter on the former, since, when profits in the periphery did not decrease sufficiently to offset the inequality between supply and demand in the cyclical centres, stocks

would accumulate in the latter, industrial production contract, and with it the demand for primary products. Demand would then fall to the extent required to achieve the necessary reduction in income in the primary producing sector. The forced readjustment of costs of primary production during the world crisis illustrates the intensity that this movement can attain.

The greater ability of the masses in the cyclical centres to obtain rises in wages during the upswing and to maintain the higher level during the downswing and the ability of these centres, by virtue of the role they play in production, to divert cyclical pressure to the periphery (causing a greater reduction of income of the latter than in that of the centres) explain why income at the centres persistently tends to rise more than in the countries of the periphery, as happened in the case of Latin America.

That is the clue to the phenomenon whereby the great industrial centres not only keep for themselves the benefit of the use of new techniques in their own economy, but are in a favourable position to obtain a share of that deriving from the technical progress of the periphery.

III. Latin America and the high productivity of the United States

The United States is now the principal cyclical centre of the world, as was formerly Great Britain. Its economic influence over other countries is obvious, and in that influence, its enormous increase in productivity has played a vital part. It has profoundly affected foreign trade and, through its variations, the rate of economic development of the rest of the world and the international distribution of gold.

The Latin-American countries, with their high coefficient of foreign trade, are extremely sensitive to such economic repercussions. An examination of the implications of the phenomenon and the problems it presents is therefore opportune.

It is a well-known fact that, in the United States, prices have not fallen in proportion to the increase in productivity as the recent research of Mr. Fabricant has clearly shown. During the period covered by that research—the forty years preceding the Second World War—manufacturing production costs declined regularly and persistently. The movement of prices did not follow this pattern at all. The increase in productivity was not reflected in prices but in income. Wages and salaries rose as real costs fell. This did not account, however, for all the benefits of productivity, as an appreciable part of it was passed on in the form of a shorter working day.

The increase in income arising out of higher productivity sooner or later extends to all phases of economic life through the well-known process, which need not be recalled here. By virtue of that same process income has also increased in activities in which technical progress has been insignificant or non-existent, as in certain types of services. In some social groups the increase was very slow; meanwhile the rest of the community enjoyed advantages which, as the necessary adjustment took place, had to be yielded to the former. This transfer, however, was usually offset by new increases in wages resulting from still higher productivity.

This fact is pointed out as a good example of the type of adjustment to which the gradual industrialization of Latin America will necessarily give rise. As productivity increases with industrialization, wages will rise, thus causing a comparative increase in the prices of primary products. In this way, as its income rises, primary production will gradually obtain that share of the benefits of technical progress which it would have enjoyed had prices declined. As in the case of the lagging social

groups mentioned above, it is evident that such adjustment will mean a loss of real income in the industrial sectors, which will, however, be limited by the import coefficient; but in the long run, that loss can be well compensated by the benefit of subsequent technical developments.

As mentioned before, since prices do not keep pace with productivity, industrialization is the only means by which the Latin-American countries may fully obtain the advantages of technical progress.

Another solution had, nevertheless, been found by the classical theory. If the advantages of technique were not passed on through prices, they would be extended to the same degree by the raising of income. We have just seen that this is precisely what happened in the United States, as well as in the other great industrial centres. It did not, however, occur in the rest of the world. It would have required, throughout the world, the same mobility of factors of production as that which characterized the broad field of the internal economy of the United States. That mobility is one of the essential assumptions of the theory. In fact, however, a series of obstacles hampered the easy movement of productive factors. Doubtless the high wages paid in the United States, as compared with those in the rest of the world, would have attracted large masses to that country, with a very adverse effect upon wages, tending to reduce the difference between them and those in the rest of the world.

Thus the observance of one of the essential rules of the classic game would have resulted in a considerable lowering of the standard of living of the United States, as compared with the levels actually achieved.

It is easily understandable that the protection of this standard of living, attained by great effort, should have prevailed over the uncertain advantages of an academic concept. But the classic rules of the game form an indivisible whole and, if one is eliminated, the others cannot logically serve as absolute standards governing relations between the centres and the periphery.

This point is the more worthy of consideration in that one of the consequences of the technical progress of the United States, so much greater than that of the rest of the world, has been another important departure from the rules.

As previously stated, the import coefficient of the United States has become extremely low, not more than 3 per cent. In 1929 it was 5 per cent. The decline is not new, but one of long standing. During the last hundred years, national income increased about two and a half times more than imports.

This phenomenon is largely explained by technical progress. Paradoxical as it may seem, increased productivity contributed to the strengthening of the United States' protective tariff policy, after that country had reached the stage of economic maturity. The explanation is simple. Over a given period of time, technical progress does not affect all in-

dustries equally. When higher wages resulting from the increased productivity of the more advanced industries are extended to the less advanced, the latter lose the advantage which had enabled them to compete with foreign industries paying lower wages. The significance of this factor will be appreciated from the fact that wages are twice or two and a half times as high in the United States as in Great Britain. Thus, tariff protection has been necessary for industries more efficient than their foreign competitors, but whose level of productivity is lower than the average for their own country. For instance, despite the great improvement of agricultural technique, some of the important branches of agriculture needed protection as a result of their relatively high incomes as compared with those of foreign competitors.

England, when it was the economic dynamic centre, followed a diametrically opposed policy. If, however, the clock could be put back, it is by no means certain that it would abide by the same policy and disrupt its economy. The United States is a powerful and well-integrated economic entity and has become so largely through its own deliberate effort, the great significance of which is recognized. One cannot overlook, however, the fact that this brought about, for the rest of the world, conditions incompatible with the functioning of international economy in the same way as before the First World War, when the British centre strictly observed the rules of the game in the fields of monetary policy and foreign trade.

It is under these new conditions of international economy, that the process of industrialization has begun to develop in Latin America. The fundamental problem lies in adaptation to these conditions—in so far as they cannot be altered—while seeking new rules in keeping with the new circumstances.

Until that happens, and possibly with slight intervals, a persistent tendency toward disequilibrium will prevail. It is due, fundamentally, to the following fact: while, as we have seen, the import coefficient of the United States has been declining, the dollar imports of the Latin-American countries are tending to increase, thus compelling them to take defensive measures to lessen the effects. There are several reasons for this:

First: since technical progress has been greater in the United States than anywhere else, the demand for the capital goods necessary for industrialization is preferentially made upon that country.

Second: technical development continuously manifests itself in the form of new products which, by modifying existing ways of life, assume the character of new necessities, of new ways of spending the income of Latin America, generally substituting them for the previous forms of domestic expenditure.

Third: in addition to those products which have undeniable technical advantages, there are others toward which demand is diverted by the considerable persuasive power of advertising. New tastes are created which must be satisfied by imports, to the prejudice of those which could be satisfied locally.

That it is not possible to reduce the import coefficient at the centre on the one hand, and to allow it to increase freely in the periphery on the other, under the influence of the above factors, was fully proved by the serious events of the nineteen thirties. We now have sufficient perspective to understand their significance and to learn the lesson that they teach. One other fact must first be mentioned.

It has already been stated that the industrialization of Latin America, if wisely carried out, will open the way to a considerable increase in national income, by giving more productive employment to vast numbers of the population at present engaged in occupations of low productivity.

It can now be seen that the rise in income so far achieved has accentuated the influence of those factors on the demand for dollar imports. The greater the rise in income in these countries, therefore, the greater their need to import. This brings us once again to the problem of dollar shortage, which demands special attention.

IV. The problem of the dollar shortage and its repercussions in Latin America

As soon as the symptoms of a dollar shortage begin to appear, the natural reaction is to look back at the not very distant past when, as shown in tables 3 and 4 and charts 1 and 2, increasingly large quantities of gold were being concentrated in the vaults of the United States. Before the First World War, that country held 26.5 per cent of the world reserves; by the beginning of the Second World War, this figure had increased to 50.9 per cent; and though at the end of hostilities it had fallen to 36.5 per cent, the United States again increased its share, which in 1948 comprised about half the world reserves.

The dollar shortage means that the United States does not purchase merchandise and services, or lend money, in an amount sufficient to cover the needs, justified or not, of other countries. This entails recourse to monetary reserves: dollars must be sold or gold sent to the United States.

Though this dwindling of reserves is not slow to give rise to monetary disturbances, the attraction of gold toward the main cyclical centre, if persistent, is not simply a monetary problem; it is the manifestation of a much deeper dynamic phenomenon related to the rhythm of economic growth of the various countries and the way in which it occurs.

Depending on the type of its own growth, the action of the principal centre may, through cyclical fluctuations, take the form either of a persistent tendency to expel gold that flows to it, and thus stimulate the economic development of the rest of the world, or that of a tenacious retention of gold, to the detriment of the dynamic forces of the rest of the world. The British cyclical centre was of the first type. So was the new principal cyclical centre before 1929. In the nineteen thirties, however, the second type prevailed, and the countries of the rest of the world were obliged to adjust their relationship with that centre in order that they might be able to continue developing, in spite of the unfavorable influence of the centre and its great absorption of metal.

The Latin-American countries shared, with the others, the hardships of the nineteen thirties. It is understandable, therefore, that, faced with the symptoms of another dollar shortage, they should examine the past, as they can now do in clearer perspective, to discover whether the same factors which were at work then are again coming into force.

Those factors relate, on the one hand, to the repercussions on the rest of the world of the contraction and expansion of the principal cyclical

centre and, on the other, to the marked reduction of its import coefficient and other foreign payments.

TABLE 3

Gold reserves of the United States and the rest of the world

In millions of dollars at 35 dollars an ounce

	United States				*Rest of world*		
Year	*Gold unadjusted (1)*	*Net short-term balances of other countries held in the United States (2)*	*Gold adjusted (3) = (1)—(2)*	*Percentage of world total*	*(4) = (5) — (3)*	*Percentage of world total*	*World total (5)*
1923......	7,190	1,102	6,088	41.5	8,558	58.5	14,646
1924......	7,698	1,303	6,395	42.	8,001	58.	15,196
1925......	7,493	1,124	6,369	41.8	8,862	58.2	15,231
1926......	6,912	1,833	5,079	32.4	10,553	67.6	15,632
1927......	6,733	2,823	3,910	24.	12,330	76.	16,240
1928......	6,342	2,234	4,108	24.1	12,919	75.9	17,027
1929......	6,603	2,337	4,376	25	13,122	75.	17,498
1930......	7,153	1,417	5,736	30.9	12,792	69.1	18,528
1931......	6,858	338	6,520	34.	12,649	66.	19,169
1932......	6,848	–325	7,173	35.5	13,029	64.5	20,202
1933......	6,792	–856	7,648	37.7	12,627	62.3	20,275
1934......	8,236	–522	8,758	40.	13,109	60.	21,867
1935......	10,124	444	9,680	44.5	12,024	55.5	21,704
1936......	11,258	819	10,439	45.8	12,277	54.2	22,716
1937......	12,760	1,208	11,552	48.	12,493	52.	24,045
1938......	14,592	1,579	13,013	50.9	12,531	49.1	25,544
1939......	17,800	2,714	15,086	59.1	10,414	41.9	25,500
1940......	22,043	3,578	18,465	63.1	10,535	36.9	29,000
1941......	22,761	3,335	19,426	64.7	10,574	35.3	30,000
1942......	22,738	3,891	18,757	54.3	15,743	45.6	34,500
1943......	21,981	5,158	16,823	47.5	16,577	52.5	35,400
1944......	20,631	5,316	15,315	42.1	20,985	57.9	36.300
1945......	20,083	6,558	13,525	36.5	23,475	63.5	37,000
1946......	20,706	5,453	15,253	40.6	22,247	59.4	37,500
1947......	22,868	4,331	18.537	48.6	19,563	51.4	38,100
1948......	24,004	4,672	19,332	50.	19,268	50.	38,600

Note. The amounts representing net short-term dollar assets belonging to the countries of the rest of the world have been deducted from the gold holdings of the United States, since they represent monetary assets belonging to these countries and not to the United States. In view of the magnitude of these assets at certain times, the effects of the adjustment are considerable. In 1947, for instance, the United States would have held 60 per cent of the world's gold, had not the exclusion of the above-mentioned dollar assets reduced that figure to 48.6 per cent.

Sources. The following procedure has been adopted in making this adjustment: (*a*) Data for the years 1931-1936, both inclusive, have been taken from *Banking and Monetary Statistics*, Board of Governors of the Federal Reserve System, Washington, 1943, pages 574-589, and after 1937 from the International Financial Statistics of the International Monetary Fund, Washington, January 1949, page 130. (*b*) The figures for the years before 1931 have been calculated by taking the net balances of the short-term capital movement according to the data for the United States balance of payments published in *The United States in the World Economy*, United States, Department of Commerce, Bureau of Foreign and Domestic Commerce, Economic Series no. 23, appendix B. In charts 1 and 2, the part of the curves before 1923 has not been adjusted owing to lack of data.

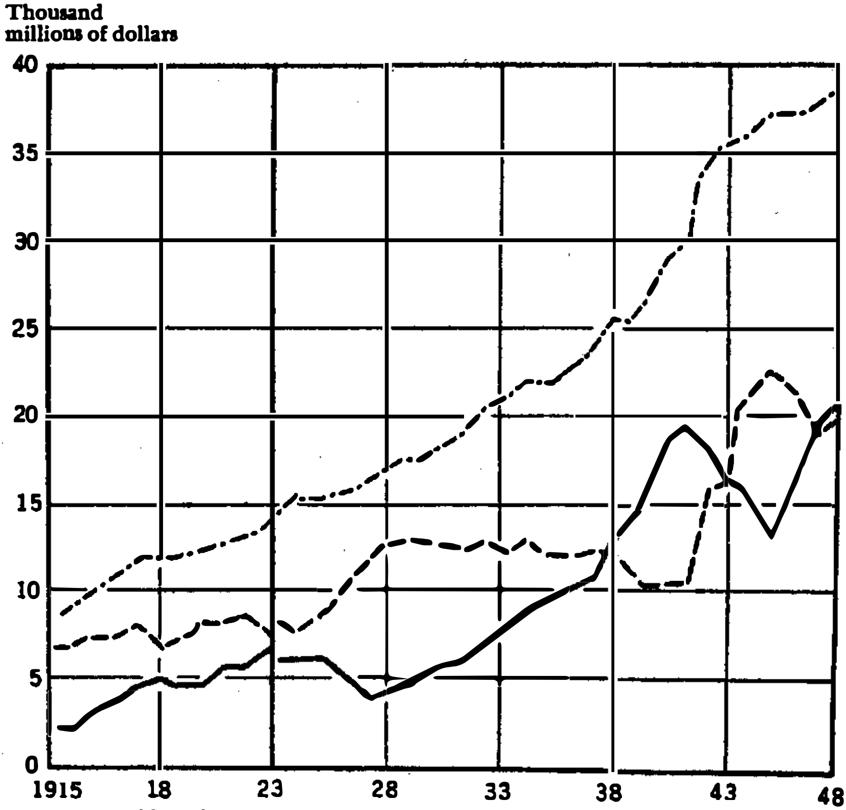
The world total has been obtained from the *Federal Reserve Bulletin* for the years before 1940, and from the *Annual Reports* of the Bank for International Settlements, Basle, for later years.

Data for 1948 are preliminary. All calculations have been made at a rate of $35 per fine ounce.

When income falls in the principal centre during the cyclical downswing, the fall tends to spread to the rest of the world. If the latter's income does not fall simultaneously and correspondingly, but with a certain lag a disequilibrium arises in the balance of payments. Since the fall in income is more rapid at the centre, the decrease in imports and other foreign payments is sharper there than in the rest of the world, with the result that the latter is forced to send gold to the centre. If equilibrium were possible—in the presence of cycles it is not—balance would be achieved when the respective incomes fell at the same rate.

CHART 1

Gold reserves of the United States and the rest of the world



—·—· World total.
- - - - - Rest of the world.
——— United States.

Note. The amounts representing net short-term dollar assets belonging to the countries of the rest of the world have been deducted from the gold holdings of the United States, since they represent monetary assets belonging to these countries and not to the United States. In view of the size of these assets at certain times, the effects of the adjustment are considerable. In 1947, for instance, the United States would have held 60 per cent of the world's gold, had not the exclusion of the above-mentioned dollar assets reduced the figure to 48.6 per cent.

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The world total has been obtained from the *Federal Reserve Bulletin* for the years before 1940, and from the *Annual Reports* of the Bank for International Settlements, Basle, for the later years.

Data for 1948 are preliminary. All calculations have been made at a rate of $35 per fine ounce.

TABLE 4

Net short-term balances of other countries held in the United States
In millions of dollars

Year	*Short-term balances of other countries held in the United States (1)*	*Short-term balances of the United States held in other countries (2)*	*Net short-term balance (3)=(1)—(2)*
1923	2,065	963	1,102
1924	2,450	1,147	1,303
1925	2,349	1,225	1,124
1926	3,119	1,286	1,833
1927	4,700	1,877	2,823
1928	4,502	2,268	2,234
1929	4,834	2,606	2,227
1930	4,346	2,930	1,417
1931	2,205	1,867	338
1932	1,261	1,586	−325
1933	664	1,520	−856
1934	610	1,132	−522
1935	1,227	783	444
1936	1,491	672	819
1937	1,929	721	1,208
1938	2,236	657	1,579
1939	3,271	558	2,714
1940	3,988	410	3,578
1941	3,724	389	3,335
1942	4,252	266	3,981
1943	5,437	279	5,158
1944	5,673	357	5,316
1945	6,987	429	6,558
1946	6,193	740	5,453
1947	5,318	987	4,331
1948	5,772	1,100	4,672

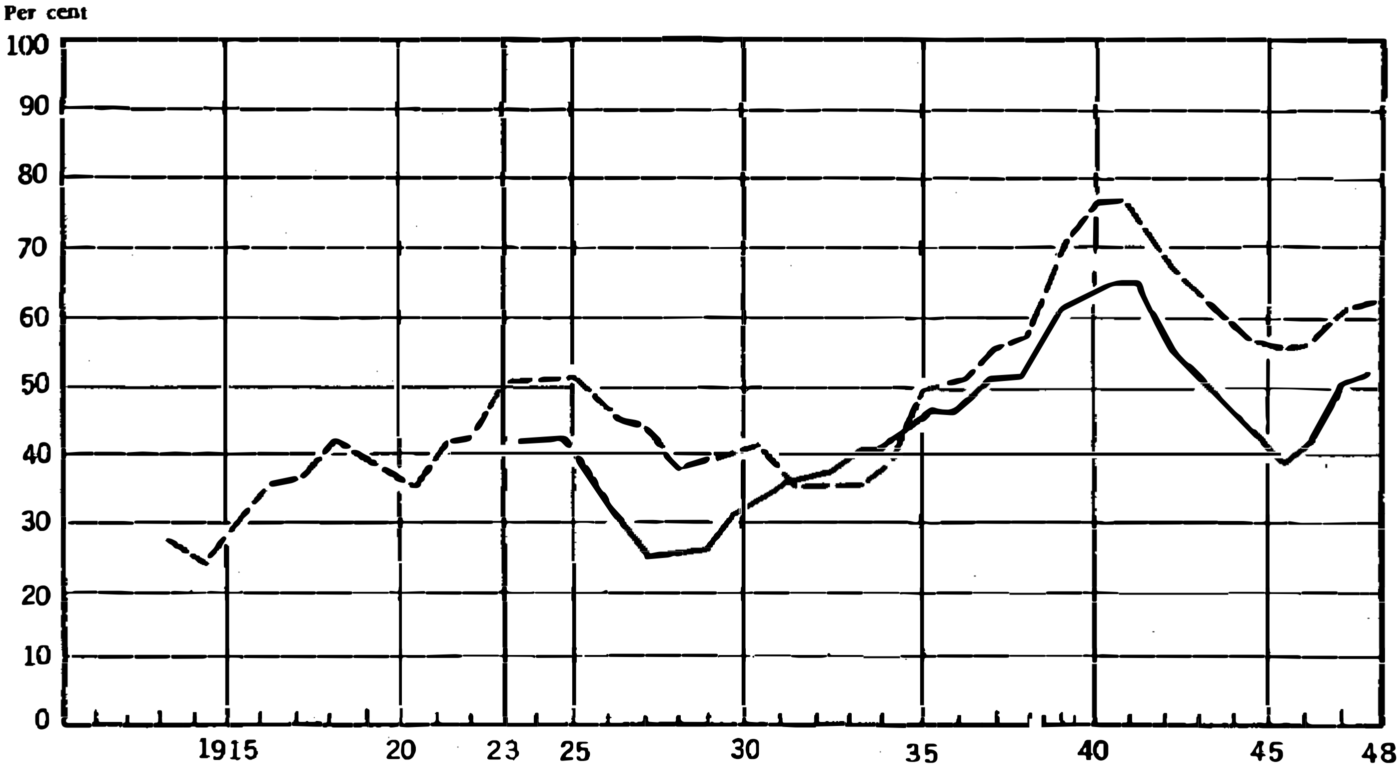
Note. Balances for the years before 1931 in columns 1 and 2 were calculated by adding to the 1931 figures the annual inflow into the United States of short-term capital owned by other countries and by subtracting the annual outflow to the rest of the world of short-term capital owned by the United States.

Sources. The data for the years 1931 to 1936, inclusive, in columns 1 and 2 have been taken from *Banking and Monetary Statistics*, Board of Governors of the Federal Reserve System, Washington, D. C.; for the years 1937 to 1948, from *International Financial Statistics*, International Monetary Fund, Washington, D. C.

The cyclical contraction that occurred in the United States after 1929 would have been sufficient to attract a great part of the gold it had lost during the previous expansion, as usually happened in the cycles of the old principal centre. In this case, however, there appeared a new factor which had not been an element of the British influence, namely, the decline of the import coefficient. This decline was chiefly the result of two events: the raising of tariffs in 1929, on the one hand, and, on the other, a greater decline in the prices of imported primary products than in those of finished products (which have the most influence on national income). Table 5 and chart 3 illustrate the intensity of this phenomenon.

CHART 2

United States' share of the world's gold reserves



Source. See chart I.

- - - - Total gold holdings, unadjusted.

——— Gold holdings after deduction of the short-term dollar assets of the rest of the world.

TABLE 5

Import coefficient of the United States
Relation of imports to income
In millions of dollars

Year	*Imports*	*National income*	*Percentage coefficient of imports*
1919	3,904	65,900	5.9
1920	5,278	76,400	6.9
1921	2,509	60,300	4.1
1922	3,112	61,500	5.0
1923	3,792	72,900	5.2
1924	3,609	73,300	4.4
1925	4,226	77,800	5.4
1926	4,430	82,800	5.3
1927	4,184	81,300	5.1
1928	4,091	83,300	4.9
1929	4,399	87,300	5.0
1930	3,060	75,000	4.0
1931	2,090	58,800	3.5
1932	1,322	41,600	3.2
1933	1,449	39,500	3.7
1934	1,655	48,600	3.4
1935	2,047	56,700	3.6
1936	2,422	66,900	3.6
1937	3,083	73,600	4.2
1938	1,960	67,300	2.9
1939	2,318	72,500	3.2
1940	2,625	81,300	3.2
1941	3,345	103,800	3.2
1942	2,744	136,400	2.0
1943	3,381	168,200	2.0
1944	3,919	182,200	2.2
1945	4,147	182,800	2.3
1946	4,908	178,200	2.8
1947	5,732	202,500	2.8
1948	6,924	224,000	3.0

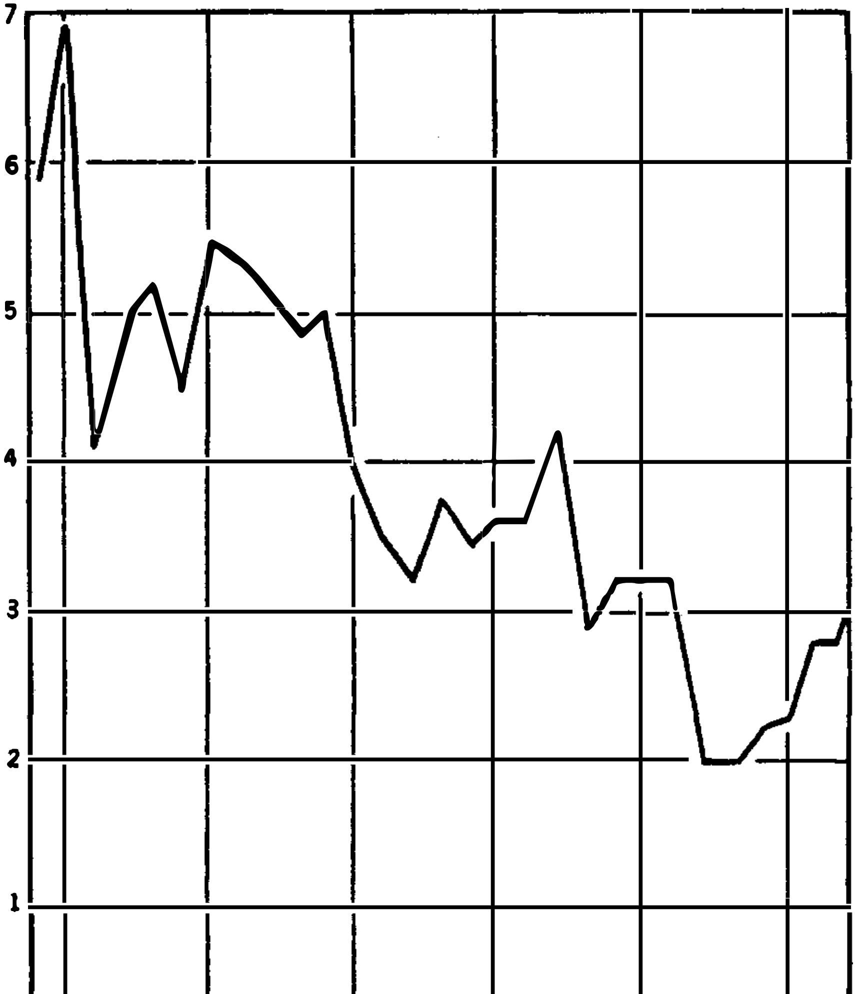
Sources: Data on income have been taken from *National Income and its Composition,* by S. Kusnetz, New York, 1941, for the period 1919-1928; from the *Statistical Abstract of the United States, 1948,* Department of Commerce, Washington, D. C., for the period 1929-1947 and from *Economic Indicators,* February 1949 (U. S. Government Printing Office, Washington, D. C.) for the year 1948. Data on imports have been taken from the *Statistical Abstract of the United States* and from *Economic Indicators.*

The decline of the import coefficient in the principal cyclical centre strengthens the tendency to accumulate gold, resulting from the contraction of income. In fact, imports in the centre fall even more sharply than in the rest of the world and the disequilibrium turns still further against the latter. To restore the balance, it would not only be necessary, as in the previous case, for the income of the rest of the world to contract as sharply as that of the principal cyclical centre, but much more sharply. The greater the decline in the import coefficient and in other external payments of the principal cyclical centre, the more must the income of the rest of the world fall below the level of that centre. It

CHART 3

Import coefficient of the United States

Imports in relation to income



Source. The data for income have been obtained from *National Income and its Composition*, by S. Kusnetz, New York, 1941 for the years 1919-1928; from the *Statistical Abstract of the United States, 1948* for the years 1929-1947, and from *Economic Indicators*, February 1949, U. S. Government Printing Office, Washington, D. C., for 1948. The data on imports were obtained from the *Statistical Abstract of the United States* and *Economic Indicators*.

must be remembered that, in addition to imports, these other external payments were also considerably reduced, by the cessation of the foreign loans made by the United States.

After the trough of the depression had been reached, in 1933, another expansion took place. According to British cyclical experience, the principal cyclical centre should have lost gold, as in fact it did during the expansion of the nineteen twenties. In the thirties, however, the opposite occurred; the monetary reserves of the United States attained extraordinary proportions, even discounting, as has been done in all the charts, the large quantity of foreign funds which, for other reasons, were deposited in dollars in the United States.

The decline of the import coefficient played a part in this. The income of the centre would have had to increase much more than that of the rest of the world for the former to cease attracting gold after the contraction and subsequently to begin losing it. The increase would have had to be great enough, first to compensate the effects of the decline in the coefficient, and then to surpass them. For instance, if the coefficient is halved, the income of the principal centre must increase to twice as much as that of the rest of the world, barely to offset the effects of such reduction.

The income of the United States, far from achieving this relatively high increase, took longer than that of the rest of the world to reach the level it had attained in 1929, judging from what took place in an important group of countries (see table 6 and chart 4).

It is thus not surprising that gold should have been steadily accumulating in the principal cyclical centre. The concentration of metal in the United States was, in fact, enormous. Practically all the new production of monetary gold in the world, which was certainly considerable after 1933, collected in that country. The reserves of the rest of the world fell slightly, as may be seen in table 3.[1]

[1] An examination has been made in the text of the factors which caused the United States to attract gold in the nineteen thirties. There were also factors operating in the rest of the world which caused the expulsion of gold. Outstanding among them were those which appeared during the two world wars. The United States acquired large quantities of gold in return for supplies furnished to the Allies. It could only have lost this gold through a much greater inflationary expansion of income than that which actually took place, a possibility which need not, therefore, be considered. This was not the only phenomenon in the redistribution of gold brought about by the two wars. Part of the gold received by the United States was transferred to neutral countries or non-belligerents, to cover their favourable balance of payments. This is a normal phenomenon in the expansion of a cyclical centre, which was reflected in Latin America by a large increase in its metallic reserves. But it is also natural that a large part of the gold should return to the cyclical centre. This is what happened during the recession which took place in the United States after the First World War, and the cyclical movements of the British centre were also marked by fluctuations of gold. The present return of gold from the Latin-American countries to the United States, however, is different, in that the movement has begun before a contraction in that country has taken place. This is due, as already stated, to the rise in imports, occasioned by the high level of employment and accentuated by inflationary phenomena.

TABLE 6

National income of the United States and of eleven other countries (Australia, Canada, Denmark, France, Germany, Japan, the Netherlands, New Zealand, Norway, Sweden and United Kingdom)
In millions of dollars

			Indices 1929 = 100	
Year	*Income of United States*	*Income of eleven countries*	*United States*	*Eleven countries*
1924	73,300	56,700	83.9	77.9
1925	77,800	57,200	89.1	78.6
1926	82,800	59,200	94.8	81.4
1927	81,300	63,700	93.1	87.6
1928	83,300	68,700	95.4	94.4
1929	87,300	72,700	100	100
1930	75,000	62,000	85.9	85.2
1931	58,800	56,200	67.3	77.3
1932	41,600	48,400	47.6	66.0
1933	39,500	60,500	45.2	83.2
1934	48,600	76,400	55.6	105.0
1935	56,700	78,300	64.9	107.7
1936	66,900	88,100	76.6	121.8
1937	73,600	91,400	84.3	125.7
1938	67,300	87,700	77.0	120.6

Sources. Data taken from *National Income and its Composition,* by S. Kusnetz, New York, 1941, for the national income of the United States during the period 1924-1928 inclusive (pages 310-11); *Statistical Abstract of the United States, 1948* for the period 1929-1938; *World Economic Development, Effects on Advanced Industrial Countries,* by Eugene Staley, Montreal, 1945, for the income of the eleven countries (page 144, chart 13).

If, in the nineteen thirties, the rest of the world had relied for its economic development solely upon the stimulus deriving from imports and other payments made by the United States, the increase of its income would have been much less than that country's. As already pointed out, this is due to the depressive effect of the decline of the import coefficient of the United States. However, this did not actually happen since, in the countries shown in chart 4, income increased to a greater extent than in the United States.

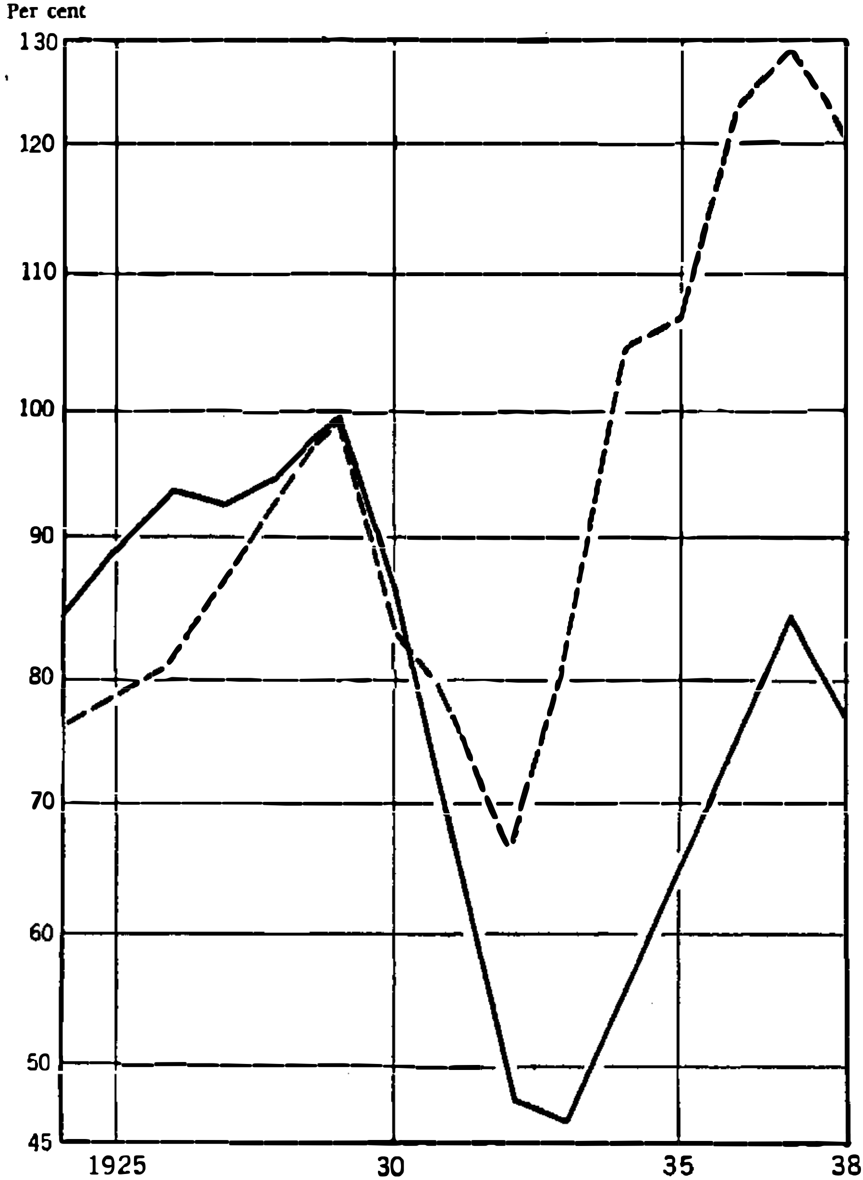
If these countries, like the rest of the world, had increased their income without changing their import coefficient, it can be safely assumed that they would not have been able to do so for long without seriously impairing their monetary reserves. If this did not happen, it was simply because they had already reduced their coefficient of imports and other payments, especially of imports from the United States, which fell more than those from other sources, in order to attenuate the contraction originating in the United States.[2] This enabled the rest of the world not only to develop in the way already described, but in several instances, to use part of its dollar exports to reduce its debt to the United States.

[2] See charts published for various countries in *The United States in the World Economy,* United States Department of Commerce, Bureau of Foreign and Domestic Commerce, Economic Series no. 23, pages 67, 68 and 69.

CHART 4

National income of the United States and of eleven other countries (Australia, Canada, Denmark, France, Germany, Holland, Japan, New Zealand, Norway, Sweden and United Kingdom)

Index numbers; Basis: 1929 = 100



. . . . . Eleven countries.
——— United States.

Source. Data for the national income of the United States have been obtained from *National Income and its Composition*, by S. Kusnetz, New York, 1941, pages 310-311, for the years 1924-1928, both inclusive; and from the *Statistical Abstract of the United States, 1948,* for the years 1929-1938. Those for the income of the eleven countries were obtained from *World Economic Development, Effects on Advanced Industrial Countries,* by Eugene Staley, Montreal, 1945, page 144, chart 18.

Why was the coefficient of imports from the United States reduced more sharply in the rest of the world than the latter's total coefficient? Obviously because the deficit in the balance of payments was more acute in terms of dollars. Had imports in other currencies been reduced to the same extent as those in dollars, the damage suffered by international trade in the nineteen thirties would have been even more severe, with consequent additional loss of its classical advantages.

What were the reactions of Latin America when faced with the phenomena occurring in those years in the principal cyclical centres? It is needless to repeat the story of the well-known way in which such events were reflected in this part of the continent, but they should serve to clarify and define the best interests of Latin America.

The reaction in Latin-America was similar to that of other countries in the rest of the world, namely, a reduction of the import coefficient through depreciation of the currency, higher tariffs, import quotas and exchange controls.

Such measures had never been applied as widely as in those days, since there had never been a shortage of pounds sterling under the monetary hegemony of London.

The rapid extension of exchange controls is explained by the pressing need to reduce imports immediately and to stem the flight of capital. However, exchange controls were a means not only of reducing the volume of imports, but also of diverting to other countries, mainly those of Europe, demand for imports which, because of their low cost and suitability to Latin America's needs, it had formerly been preferable to bring from the United States. Notwithstanding its implications, it would be difficult to deny the obvious fact that exchange control has, in many instances, been used as an instrument of discrimination in international trade, contrary to the sound practices established with great effort through the general application of the most-favoured-nation clause. It must, nevertheless, be recognized that, when a country lacked the dollars necessary to pay for its essential imports, the only way out of so critical a situation seemed to be to import goods payable in currencies received in payment of exports.

Had these other currencies been convertible into dollars, the situation would have been very different. However, the dollar shortage affected all the rest of the world, and multilateral compensation could not be achieved when the total balance due in dollars exceeded available supplies.

Exchange control was not the result of a theory but was imposed by circumstances. None who had first-hand knowledge of the complications of every kind that it involved would have adopted such a measure, had

there been other alternatives available or had it been within the power of the Latin-American countries to eliminate the fundamental causes of the evil.

Unfortunately these causes persisted too long. The abandonment of exchange control might have been considered when the worst of the world crisis was past and economic recovery in full swing, but the way in which the principal cyclical centre functioned made such a possibility remote.

Table 7 and chart 5, showing the monetary reserves of Latin America, reveal the nature of the difficulties. Imports and other payments usually absorbed all the dollars newly added to the reserves and even a part of the reserves themselves. Exchange control, as already stated, served the purpose of diverting the demand for imports that could not be so financed. Even so, in the nineteen thirties it could not prevent total monetary reserves from remaining at a level considerably lower than that maintained in the nineteen twenties.

Such was the significance of exchange control in those days. Whether handled well or badly, it was the means of mitigating the serious repercussions of events abroad on the internal activity of the Latin-American countries. Later, however, its functions changed considerably. Exchange control has been, and still is, used to check the effects of internal inflationary expansion on imports and other liability items in the balance of payments. It is evident that in this instance exchange control, instead of counteracting the effects of inflation, diverts the inflationary pressure toward internal activity, thus accentuating the rise in prices.

The same considerations thus do not apply in both cases. Latin-American countries had no influence over the external factors that imposed exchange control in the nineteen thirties. On the other hand, the factors operating today are dependent upon their own decisions, as Latin-American governments, concerned as they are at the gravity of this problem, have more than once admitted.

It is difficult, if not impossible, to determine to what extent the scarcity of dollars, which once more faces several Latin-American countries, is the result of the low import coefficient of the United States and to what extent it is the result of the inflationary pressure referred to above.

It has already been explained that the high level of employment attained in Latin America entails a considerable volume of dollar imports. Meanwhile, as its national income had reached an extremely high level, the United States also increased its imports from Latin America and other countries of the world. In 1948, its total imports amounted to 6,900 million dollars, with a coefficient of only 3 per cent. Had the coefficient been 5 per cent, as in 1929, imports would have totalled 11,500 million. These figures show the magnitude of the effects produced by the decline of the import coefficient.

It is still too early to say whether or not the Latin-American countries' share of these imports will provide them with sufficient means of covering their import needs in addition to the other payments they have to make to the United States. A considered opinion cannot yet be given. Information is still very inadequate and does not permit an examination of the composition of imports for the purpose of determining with sufficient accuracy how much of the increase has been due to the redistribution of income typical of inflation. There are instances of considerable dollar payments for imports wholly unrelated to industrialization or the mechanization of agriculture, but it is difficult to say to what extent such cases can be considered general.

TABLE 7

Gold reserves of Latin-America
In millions of dollars at 35 dollars an ounce

Year	*Seven countries (Argentina, Bolivia, Brazil, Chile, Peru, Uruguay and Venezuela)*	*Twelve countries (Colombia, Ecuador, El Salvador, Guatemala, Mexico, plus seven in Column I)*
1913	611	..
1914	521	..
1915	498	..
1916	568	..
1917	649	..
1918	724	..
1919	816	..
1920	1,100	..
1921	1,095	..
1922	1,099	..
1923	1,090	..
1924	1,066	..
1925	1,083	..
1926	1,048	..
1927	1,257	..
1928	1,475	..
1929	1,180	1,257
1930	892	940
1931	656	689
1932	579	619
1933	585	614
1934	583	640
1935	647	721
1936	714	794
1937	656	712
1938	638	705
1939	693	760

Note. Since figures for the first years of this period, starting with 1913, are available for only seven countries (Argentina, Bolivia, Brazil, Chile, Peru, Uruguay and Venezuela), the curve on chart 5 has been drawn up to 1939, and on this curve, starting with 1929, has been superimposed another including five more countries (Colombia, Ecuador, El Salvador, Guatemala and Mexico). These figures represent gold reserves only. All data are expressed at the rate of 35 dollars per ounce.

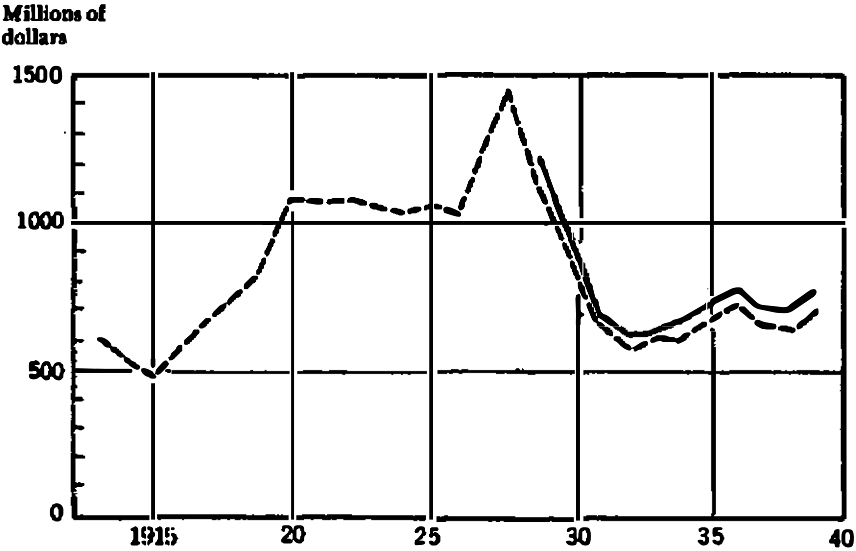
Source. Banking and Monetary Statistics, Board of Governors of the Federal Reserve System, Washington, D. C., 1943.

In any case, very special attention should be paid to the events now taking place. For instance, the recommendations recently made by the Joint Brazil-United States Technical Commission in its interesting report on Brazil are decidedly symptomatic.

There is great similarity between the measures envisaged by the Commission in connexion with imports and those which, as recalled above, several Latin-American countries were compelled to take in the nineteen thirties.

CHART 5

Gold reserves of Latin-America



. . . . . Includes seven countries.
——— Includes twelve countries.

Note. As data for the earlier years of this period, 1913-1939, were available for only seven countries (Argentina, Bolivia, Brazil, Chile, Peru, Uruguay and Venezuela) the appropriate curve including them is shown until 1939. Five additional countries (Colombia, Ecuador, El Salvador, Guatemala and Mexico) are included in the second curve covering the years 1929-1939. These figures refer only to gold reserves and were calculated at the rate of $35 per fine ounce.

Sources. Monetary and Banking Statistics, Washington, 1943, for the years 1913-1936; and *International Financial Statistics*, Washington, 1949, for the years 1937-1939.

Despite the great increase in Brazil's dollar exports, the Commission has shown that they are not sufficient to cover its imports in that currency. It therefore approves the restriction of non-essential imports through a more effective application of the system of exchange control and recognized that "it would be necessary for Brazil to obtain its essential imports, as far as possible, from soft-currency countries with which it has had a 'favourable' balance of trade in recent years", and adds

that "one measure which might assist in reducing the total of hard currency imports, would be to require a review by the control authorities of all purchases in the dollar area proposed to be made by Brazilian government departments and 'autarquias' ".[8]

It is remarkable that a report of this nature should envisage not only the restriction of imports through exchange control, but also the application of discriminatory measures.

The case would be of no great significance if it were merely a recognition of the temporary need for relieving pressure on the balance of payments. If, however, it is the expression of something more fundamental and persistent, the Latin-American countries would have serious cause for concern.

Experience has shown that multilateral trade is the best suited to the economic development of Latin America. The ideal would be to be able to buy and sell in the best, though perhaps different, markets, without dividing foreign trade into water-tight compartments. The situation in which sales to Europe must be strictly counterbalanced by purchases from that continent, or even from each European country, with no possibility of using the balances for purchasing from the United States the goods which best satisfy the needs of Latin-American economic development, is not a solution that offers the undeniable advantages of multilateral trade.

It is essential, if multilateral compensation is to be practicable, that Europe have a dollar surplus with which to pay for its excess purchases from Latin America, after having satisfied its own import requirements from the United States.

This is, without doubt, the difficulty encountered by the Joint Brazil-United States Technical Commission. In the face of it, the Commission had only two alternative courses of action: either to propose the measures it actually recommended to Brazil or to suggest application of restrictions to all the countries equally, to the detriment not only of the exports of those countries with which Brazil has a favourable balance, but also to the rate of its economic growth.

The events of the nineteen thirties seem to have left the conviction that no fundamental solution can be expected from trade with the United States. Indeed, if the present extremely low import coefficient is maintained, its imports might be insufficient to solve the latent problem of a dollar shortage, even on the favourable assumption that maximum employment in that country would last. If, with maximum employment, income were to rise in the future at a rate unlikely to prove much more than 3 per cent a year, a corresponding increase in imports from the rest of the world would not do much to relieve the dollar pressure.

[8] *Report of the Joint Brazil-United States Technical Commission*, Rio de Janeiro, 1949, pages 32-33.

Is there, however, no possibility of an increase in the import coefficient of that country, whereby its imports would increase more rapidly than national income?

The possibility does exist. The persistent attraction of gold toward a principal cyclical centre is only conceivable theoretically when there is a considerable margin of unemployed factors of production.

There could be no repetition of the phenomena of the nineteen thirties if the United States were able to maintain maximum employment and if the rest of the world, thus stimulated by the principal centre, were able to carry out a similar policy of full utilization of its growing productive factors.

As explained in connexion with the adverse experience of those years, since there was unemployment in the United States, the rest of the world could not maintain its import coefficient with respect to that country without adjusting it to that of the United States with respect to the rest of the world, as no country can carry a permanent deficit in its balance of payments. Maximum employment, however, can alter the situation very much, as a brief reasoning will show.

Let us assume that a relatively high coefficient of the rest of the world, or better still a coefficient increased by the industrialization of Latin America, causes a sharp rise in the demand for exports from the United States. Let us further assume that, through the growth of productive factors, income increases annually by, say, 6,000, of which 4,000 represents factors employed in the export industry to satisfy the great demand and the remaining 2,000, industries supplying domestic needs, with an equivalent volume of production.

It is obvious that this volume of 2,000 will be insufficient to satisfy the internal demand created by the expenditure of the 6,000 income. Demand will then exceed supply, and since internal factors are fully employed, the deficit of production for internal requirements will have to be covered by imports.

If the productive factors were not fully employed, the excess of demand over supply would tend rather to stimulate internal production, and imports, far from rising in proportion to excess demand, would show only a slight increase, representing that part of the excess which is barely reflected in a demand for foreign goods, owing to the low import coefficient.

The nature of this report precludes more detailed development of the argument. It should be pointed out, however, that for such machinery to function, it is essential that the rest of the world be able to satisfy the United States' increased demand for imports, since the process would otherwise be inflationary. At the same time, the countries increasing their coefficient or their real income should be assured of sufficient resources to face a temporary disequilibrium in their balance of payments, pending the reaction of the principal cyclical centre.

In short, with full employment at the cyclical centre, any increase in its exports to the rest of the world, brought about by the action of the latter, would tend to be accompanied by a corresponding increase in imports (or other payments abroad) and gold would not tend to concentrate at the centre, to the detriment of the other countries.

It is clear that if this is to be achieved, the centre must not lower its import coefficient. In any case, what purpose would be served by such a measure if all productive factors are already fully employed? It is understandable that internal production should be substituted for imports in order to increase employment when there are unemployed factors. It is also understandable that, even when there is full employment, a country should avoid the sacrifice, through foreign competition, of industries supplying domestic consumption to favour those producing for export, as happened in the case of the British cyclical centre during the nineteenth century. Where full employment exists, however, it would show a lack of economic sense to lower the import coefficient generally while at the same time encouraging the development of certain industries producing for domestic consumption, at the expense of international trade.

Consequently, if nothing should hamper the natural play of economic forces, where there is full and growing employment at the principal cyclical centre, the way should be clear for the solution of that fundamental problem which is of such concern to the countries of Latin-America and the rest of the world. The import coefficient of the United States would certainly increase, even if existing tariffs were left unaltered, and its interdependence with the rest of the world would be strengthened. Thus it could be demonstrated that, in addition to full employment, the United States could achieve two other fundamental objectives of its economic policy: the active promotion of foreign trade and the furthering of Latin-American industrialization.

Another theoretical consideration closely related to the foregoing questions should be noted before closing this section. As yet nothing positive has been achieved in the attempt to explain, with the help of the classical theory, the fluctuations of the balances of payments and the international movements of gold in the nineteen thirties. Such an attempt could hardly have been successful, since, as is well known, the classical theory is based on the assumption of full employment. If this assumption were to take place in reality, the essential soundness of the classical reasoning regarding gold movements could be proved, allowing, of course, for the partial modifications which the theory demands. As Lord Keynes pointed out in his *General Theory*, with full employment we are safely ensconced in a Ricardian world. The opinion expressed on this, in his posthumous article published in the *Economic Journal*, is, therefore, not surprising: "I find myself moved, not for the first time, to remind contemporary economists that the classical teaching embodied some per-

manent truths of great significance, which we are liable today to overlook because we associate them with other doctrines which we cannot now accept without much qualification. There are in these matters deep undercurrents at work, natural forces, one can call them, or even the invisible hand, which are operating towards equilibrium . . . Admittedly, if the classical medicine is to work, it is essential that import tariffs and export subsidies should not progressively offset its influence. It is for this reason that one is entitled to draw some provisional comfort from the present mood of the American Administration and, as I judge it, of the American people also, as embodied in the Proposals for Consideration by an International Conference on Trade and Employment. We have here sincere and thoroughgoing proposals, advanced on behalf of the United States, expressly directed towards creating a system which allows the classical medicine to do its work".[4]

[4] Lord Keynes, "The Balance of Payments of the United States", *The Economic Journal*, June 1946, pages 185 and 186.

V. Capital formation in Latin America and the inflationary process

The margin of savings depends ultimately upon the progressive increase of labour productivity. Though the level of productivity achieved by some Latin-American countries is such that, by means of a judicious policy, they would be able to reduce the amount of foreign capital needed to supplement national savings to moderate proportions, in the majority of them this capital is admittedly indispensable.

In actual fact, productivity in these countries is very low owing to lack of capital; and the lack of capital is due to the narrow margin of savings resulting from this low productivity. The temporary help of foreign capital is necessary if this vicious circle is to be broken without unduly restricting the present consumption of the masses, which, generally speaking, is very low. If this capital is effectively used, the increase in productivity will, in time, allow savings to accumulate which could be substituted for foreign capital in the new investments necessitated by new technical processes and the growth of the population.

Throughout most of Latin America, the characteristic lack of savings is the result, not only of this narrow margin, but, in many cases, of its improper use. Saving means refraining from consumption and is thus incompatible with certain types of consumption peculiar to relatively high income groups.

Great disparities in the distribution of income may be, as they have been in the past, a factor favourable to the accumulation of capital and technical progress. Although the influences of that factor in the Latin-American countries should not be overlooked, there are many well-known examples of how such distributive inequalities have fostered types of consumption peculiar to countries of high productivity. Considerable opportunities for saving and effectively employing monetary reserves for productive imports are thus frequently lost.

It is the increase in productivity that has enabled the United States, and to a lesser degree other industrial countries, to shorten the working day, raise the real income and standard of living of the masses, and considerably increase public expenditure, without impeding a huge accumulation of capital.

It is a well-known fact that fiscal expenditure, which, in the middle of the last century, formed a relatively small part of national income in the

great industrial countries, today represents a large portion of it. This has become possible only as a result of increased productivity.

The Latin-American countries have also followed this general tendency. If, where productivity is high and the accumulation of capital considerable, the increase in the proportions of public expenditure is cause for concern, it must be even more so in countries where a considerable part of the national income must be devoted to saving, since saving is necessary to attain that increase in productivity without which the aim of raising the standard of living of the masses would be a mere illusion.

The problem is essentially one of estimating needs. The resources available to satisfy the enormous individual and collective needs of the Latin-American countries are relatively small, and the possible contribution of foreign capital is also limited. Those needs must therefore be evaluated from the standpoint of the aim in view, in order that the limited resources may be most advantageously distributed. If the aim is to increase the measurable well-being of the community, the increase of capital per man must take very high priority. There are various types of public and private investment which are indisputably useful for this purpose, but since they do not increase productivity, they cannot bring about the increase in saving necessary for new investments. On the other hand, those same investments, if put into efficient capital goods, will immediately increase productivity and so develop a margin of saving which, transformed into new investments, will give rise to yet further increases in productivity.

For these and many other reasons, the problem of capital formation is of the utmost importance.

The considerable pressure of those individual and collective needs on comparatively scanty resources usually provokes inflationary processes such as those with which the governments are now so rightly preoccupied. At the same time there has grown up a belief, not only among the privileged, but also among those whose only concern is the general welfare, that inflation is an unavoidable means of forced capitalization where voluntary saving is evidently insufficient.

It is a thesis worthy of careful examination. Since the process is widespread, there is a wealth of data available for fruitful investigation which will later permit an appreciation of its value and range. Meanwhile, some comments may contribute to define this problem.

One indisputable fact stands out: the stimulus of monetary expansion has led to a high level of employment and thereby to a real increase in income. It appears, however, that a large part of that effect had already been achieved during a phase of moderate credit expansion which preceded the acute inflationary process. As that process developed, the increase in employment and real income became less and less marked, and that of prices more so, with consequent disturbances in the distribution of total income.

This experience provides both positive and negative lessons.[1] The positive lesson is pertinent to the subject since the growth of employment brought about an increase in the potential margin of savings. The negative lesson is also concerned with it. The exaggeration of the stimulus necessary for the achievement of maximum employment led internally to excessive inflationary pressure, which, with the rise in imports consequent upon the resumption of foreign trade after war-time restrictions, absorbed a large part of the gold and dollars which had been accumulated.

The fragmentary information available raises more than one doubt as to whether those reserves have been used in strict accordance with the needs of the economic development of Latin America. In order to throw light upon those doubts, it would be interesting to discover to what extent the aforesaid reserves have been used to import the most essential capital equipment, how far they have been spent on non-essential articles or those related only to the mode of living of high-income groups, and to what extent they have served to cover the capital outflow caused by the process of inflation.[2]

These different uses of foreign exchange are closely linked with the internal effects of inflation. The rise in prices, by creating exceptional profits, places in the hands of a comparatively small group great opportunities for saving, as always happens when income distribution is altered in such a way. It would be extremely interesting to ascertain to what extent these opportunities have been translated into collective savings and whether those savings have been put to the most productive use from the standpoint of the community.

If a large part of the profits arising out of inflation had actually been saved and efficiently invested, those who expound the foregoing thesis would have a strong point in their favour. Unfortunately isolated figures do not provide sufficient reliable evidence to justify any generalization. None the less, the information on Brazil presented by the Joint Brazil-United States Technical Commission is illuminating. In 1946 the large corporations reinvested 30 to 40 per cent of their profits and distributed the rest among the shareholders. The amount distributed by all the corporations is believed to have amounted to 12,000 million cruzeiros, of which one fourth, or barely 3,000 million, represented various forms of

[1] The possibility of a rational policy of employment of idle or ill-employed resources has been shown by experience. At one time exports had constituted the chief dynamic factor. After the world crisis, however, they proved insufficient to fulfil adequately their role of stimulating development. In the nineteen thirties, the weakness of the external dynamic factor had already been counteracted in some of the Latin-American countries by a policy of internal stimulation. In order to do so, as was explained elsewhere, it was necessary to reduce the import coefficient. The events of the Second World War showed how much further this policy could be carried. The war brought about a drastic reduction of the coefficient, while at the same time increasing the force of the external stimulus.

[2] It is interesting to note that Latin-American private deposits in the United States amounted to $729 million on 30 June 1947.

saving.[8] Taking the figures as a whole, only about 50 per cent of total profits would represent direct or indirect investments.

That being so, the proportion consumed would have been considerable. Since, moreover, the high-income groups have a high import coefficient, it is not surprising that a large part of the foreign exchange accumulated should have been spent on products not essential to economic development, as may be inferred from other information from the same source.

There is yet another aspect of the question to be clarified. Assuming that under given circumstances a certain amount of inflationary expansion is considered the most practical expedient, in view of the scarcity of savings, there would be ways of best achieving that purpose, at the same time mitigating the serious consequences of the inflation. The State has means of stimulating the investment of a large portion of profits and inflationary incomes through progressive taxation of the part spent and consumed, while lowering the tax or granting exemption on the part invested; furthermore, through exchange control or taxation, it can divert the part which tends to be used for imports incompatible with strong economic growth. Such means may, of course, also serve to increase unproductive public expenditure instead of savings, to the detriment of an increase in national productivity.

Logically, if some groups have benefited considerably from inflation, others must have suffered. Conclusive studies have not yet been made, but it would seem that there is no essential difference between inflation today and in the past. The middle class and the fixed-income groups have generally been those to bear the brunt of the transference of real income to entrepreneurs and other beneficiaries. The better organized labour unions have through wage increases managed to overtake, and at times surpass, the price rise, although usually with a lag. There are not enough reliable data, however, to ascertain to what extent the whole group has benefited and not merely certain sectors. Nevertheless, it should not be forgotten that the increase in employment during the first stage of the expansionary process has usually meant an increase in the real income of the working class family, even when wages have not been adjusted to rising prices.

All this redistribution of income brought about by inflation creates in the sectors that benefit the illusion that the total wealth of the community is increasing, even though real income ceased to rise to any extent, once the initial stage of moderate expansion was passed. It is an illusion peculiar to the stage of euphoria and prodigality; during that time capital equipment is not renewed, as in the case of transport and other public and private investments, and a large part of the previous increase in monetary reserves is spent in a short while. This means the consumption of accumulated capital and so must not be mistaken

[8] Report of the Joint Brazil-United States Technical Commission, part III.

for a real increase in income. The illusion begins to fade during the second phase—that of increasing tension—and finally disappears during the third—that of painful readjustment.

The first stage seems to be over in Latin America, and as the second develops, acute social antagonisms are appearing, which threaten the efficacy of the existing economic system. An atmosphere unfavourable to the smooth development of that system is being created, and with it certain kinds of governmental intervention and fiscal measures prejudicial to private initiative and undermining the sense of individual responsibility. Thus the inflation that has greatly increased the remuneration of the entrepreneur ends by impairing his efficiency—a factor of vital importance for the growth of the Latin-American countries.

The State soon takes a substantial share of the entrepreneur's inflationary gains in the form of taxes. The increase in public expenditure resulting from that participation will present a problem no less serious than the others, when inflationary profits disappear and it becomes necessary to bring State wages and salaries into line with the cost of living, with the obvious risk that the proportion of national income represented by public expenditure will again rise, to the detriment of capital formation.

Sound conclusions regarding the value of inflation as an instrument for collective saving can be drawn only after an objective analysis of the above facts and of others arising out of it. Whatever the final figures, it will have to be admitted that inflation has tended to discourage typical forms of voluntary saving which had acquired growing importance in some Latin-American countries. Here may be found the source of future savings for industrialization, when monetary stability can be restored in accordance with the new rules of the game imposed by new conditions. In short, if the forced savings which accumulate through inflation are furnished by many sections of the community whereas the benefits thereof are passed on to favoured groups only, the question arises whether it is not possible to devise other forms of saving (either voluntary or collective) by which resources could be better devoted to productive ends, without the serious social disadvantages of forced saving.

Meanwhile an appeal to foreign savings appears inevitable. Unfortunately, in this connexion the problem inherited from the disastrous experience of the nineteen thirties is still far from solution. While the default of the debtor is still fresh in the memory of the creditor countries, there is a tendency both to forget the circumstances in which default occurred and to spread the mistaken belief that a recurrence of past events could be avoided by the observance of certain rules of procedure. At the root of this we find the same fundamental problem as was mentioned in connexion with foreign trade trends. This was pointed out by the United States Department of Commerce in a study published some years ago.[4]

[4] *The United States in the World Economy*, Economic Series no. 23, Washington, D. C., 1943, page 6.

In 1929 the United States supplied the rest of the world with $7,400 million in payment of imports, investments and other items; hence the rest of the world could easily pay the $900 million due in fixed financial services on capital invested by the United States, apart from remittances of profits. In 1932, however, the supply of dollars was reduced to $2,400 million, while the services, had they been paid, would still have amounted to $900 million. The rest of the world would thus have had barely $1,500 million to cover its imports and other payments to the United States, as against $6,500 million in 1929.

In the light of these figures, it is not surprising that default was more or less general throughout Latin America. The few countries that continued to meet their obligations did so at great sacrifice, at the cost of a severe contraction of their internal economy and to the detriment of their monetary reserves. It is only natural that, after such an experience, they should be reluctant to find themselves once more in a position in which they must either fail to meet their obligations or sacrifice their economy.

Until a solution to the fundamental problem of foreign trade is found, care must be taken that dollar investments, where they cannot be used to further dollar exports, shall contribute, directly or indirectly, to the reduction of imports in that currency, in order to facilitate future payment of services.

From this and other points of view, it would seem imprudent to renew the active flow of investments of the nineteen twenties without adopting a plan to deal with the series of concrete problems which arise in this connexion. The existence of international credit institutions could be a very effective factor in the drafting of such a plan, in which the types of investment best suited to the development of Latin-American economy through their contribution to productivity and to the development of the necessary capacity for repayment may be considered in co-operation with the individual countries concerned.

There seems no reason why this plan should not include the field of private investment. Much is heard about the need for establishing a system of guarantees or regulations in order to promote it. All this is worthy of further consideration. New measures must, however, be developed in the light of past experience. There were many other difficulties besides the fundamental ones of the nineteen thirties, and the abuses on both sides should be fully admitted in order to prevent a repetition of the evil. In this way, and with effective technical assistance, it should be possible to develop an investment policy that would be welcomed by all concerned because of its reciprocal advantages.

VI. The limits of industrialization

It is obvious that the economic growth of Latin America depends on the increase of the average income per inhabitant (which in most countries is extremely low) and on an increase in population.

An increase in the average income per inhabitant could be achieved in only two ways: first, through an increase in productivity; and second, assuming a certain level of productivity, through an increase in income per man engaged in primary production, in relation to the income of the industrial countries which import part of that production. This readjustment, as already explained, tends to correct the disparity in income brought about by the way in which the benefits of technical progress are distributed between the centres and the periphery.

We shall now consider the increase in productivity in relation to the existing population. There are two aspects of the question. On the one hand, the adoption of modern technique will allow production per man to increase, making labour available to increase production in the same activities in which it was already employed, or directing it to others. On the other, the index of productivity will also be raised by the diversion of persons ill-employed in activities where the very low productivity cannot be increased to any notable extent, to others where technical progress makes such improvement possible.

Agriculture offers a typical example of the influence of technical progress. In some of its important branches, technical development has made possible a steady increase in production with a proportionally lower increase in employment. In other words, agriculture absorbs a decreasing proportion of the increase in the population of working age, with the result that industry and other activities have been able to increase their employment more. This is not a case of diverting, to other work, people already employed, but of offering a different form of employment to people reaching working age. There have, however, been instances in which the rapid growth of industry during recent years has brought about an actual transference of workers, with unfavourable consequences for agriculture.

Furthermore, the increase in foreign demand for agricultural products after the great depression was, in general, relatively slow, by comparison with the rate in previous years. Taking this fact in conjunction with the consequences mentioned above, it would be difficult to say what productive activities, other than industry, could have absorbed the increase in population of the Latin-American countries which export such products.

It is quite possible that technical progress in other activities will bring consequences similar to those just pointed out. That, too, will mean an important source of man-power for industrial development.

This is not the only possible source. The low level of productivity in industry itself represents a wastage of man-power which, given the proper use of modern technique, can be employed to great general advantage in expanding existing industries or in developing new ones.

Finally, there is another possibility which the recent experience of some countries has shown to be worthy of consideration. The low income level prevailing among the masses has made it possible for the higher income-groups to enjoy hand-made goods and certain types of personal services at comparatively low prices. This is due to what we have termed ill-employed man-power. As productivity in industry increases and real income, *per capita,* rises, there is a natural tendency for the ill-employed to move towards industry. However disturbing this trend may be to some sectors of society, it is the usual way in which the benefits of technical progress are passed on to all social groups within a country, as the experience of the great industrial countries has shown. The solution does not lie wholly in an increase in productivity, however. The social aim of industrialization might well be jeopardized if too large a part of the increase were to be devoted to increasing consumption or to a premature slackening of productive effort.

It has been emphasized that, to achieve this increase in productivity, capital, *per capita,* must be considerably increased and the technique for its effective use acquired. The need is progressive. In fact, a general increase in wages resulting from greater productivity in industry gradually spreads to other activities, which are thereby obliged to use more capital, *per capita,* in order to achieve the increase in productivity without which they would be unable to pay higher wages. Thus many activities in which human labour is now more profitable, because it is cheaper, will tend to become mechanized; the same will happen to a certain degree in household economy.

It is not possible to estimate, even approximately, the extent of these potential capital requirements and thus of the resources that will be needed to satisfy them, since even present capital, *per capita,* employed in the principal Latin-American countries cannot be determined with any satisfactory degree of accuracy. However, to judge from the needs which have already arisen during the initial stage of the industrialization process, the resources made available by exports—at least by dollar exports—do not appear adequate to meet those requirements after other imports and foreign payments have been met.

As already explained, the possibility must be faced that a reduction in the import coefficient may be necessary. This may apply to either the general coefficient or the dollar coefficient and may be brought about by

decreasing or eliminating non-essential goods, in order to allow increased imports of capital goods. A change in the composition of imports would in any case appear essential to the development of industrialization.

It should be clearly understood what this means. It is merely the adaptation of imports to the resources made available by exports. If the latter were to rise sufficiently, it would not be necessary to restrict imports, except as a further means of intensifying industrialization. Exports from Latin America, however, are largely dependent on fluctuations in income in the United States and Europe and on their respective import coefficients for Latin-American products. Consequently they cannot be controlled directly by Latin America, and the situation can be changed only by the decision of the other countries.

It would be a different matter if Latin America intended to carry industrialization to the point of directing certain factors away from primary production to industry in order to increase the output of the latter to the detriment of the former: in other words, if Latin America, being in a position to maintain exports and imports at a specified level, were deliberately to lower it, sacrificing part of its exports in order to increase industrial production as a substitute for imports.

Would there in that case be an increase in productivity? At this point the question would be defined in classical terms. It would be a matter of discovering whether the increase in industrial production brought about by the factors diverted from primary production was or was not greater than the amount of goods formerly obtained in exchange for the exports. Only if it were greater, could it be said that there was an increase in productivity, from the standpoint of the community; if it were not, there would be a loss of real income.

This then is one of the most important limits of industrialization, one of a dynamic nature which might become less restrictive as the economy developed but which should be constantly borne in mind, however, if the primary objective is to increase the real welfare of the masses.

There is no sign that Latin America is approaching this limit. It is in the initial stage of the industrialization process and in most cases the man-power available as a result of increased productivity is still amply sufficient for industrial growth. Moreover, it does not seem that the countries in which this process of industrialization has reached a more advanced stage have yet been driven to choose between an actual increase in exports and industrial development.

Nevertheless, exports can be sacrificed to an illusory increase in real income long before the possibilities of intensifying productivity or of utilizing all the man-power available have been exhausted.

An increase in productivity requires a considerable increase in capital, and before this can be achieved, a long time will elapse and new techniques will appear which may call for further increases in capital, in

addition to that necessitated by the growth of population. At the same time, savings are scarce. It is necessary, therefore, to use them in such a way as to obtain the maximum increase in output. However, a mistaken policy could cause deficient use of these savings, as can be easily demonstrated.

It has been said that technical progress in agriculture and the comparatively slow foreign demand for its products have, in many cases, allowed industry to absorb a larger part of the increase in population of working age than agriculture. Let us assume that year after year this increase in hands is required in agriculture in order to meet rising foreign demands in addition to the increase in domestic consumption, but that, as a result of various measures, industrial development is expanded to such an extent that agriculture is deprived of the hands it needs in order to continue increasing exports.

The reasons why the substitution of industrial production for exports may represent a loss of real income have already been explained. There would, however, be also another loss. Land is a very valuable factor of production, which costs nothing. By comparison with industry, the amount of capital that must be added to it is relatively small. Consequently, the men who could have worked efficiently in agriculture occasion a demand for more capital when employed in industry. That increased capital could, however, have been put to more productive use if, instead of being diluted in the total annual increase in population, it had been confined to a part of that increase: the higher capital per man would have resulted in greater productivity. Hence, the dilution of capital would not have allowed the increase in productivity that otherwise might have been obtained. Thus to the direct loss would be added another, which, although less tangible, would be nonetheless real.

Furthermore, if productivity did not increase, there would be less incentive for ill-employed persons to go into industry, with the result that, instead of man-power being used to the best advantage, it would be disadvantageously diverted away from highly productive occupations.

This is not a remote possibility, but a danger to which Latin America is continually exposed and into which it may sometimes have fallen for lack of economic development programmes with specific aims and clearly defined means to achieve them. Capital is scarce and it would indeed be deplorable to invest it where it would lessen total productivity rather than where it could increase it.

It should therefore not be forgotten that the greater the exports from Latin America the greater may be the rate of its economic development. We should not, however, lose sight of the possibility that a recrudescence of protectionist policy in countries that import from Latin America might lead to the replacement of those imports with goods produced locally.

Such a turn of events would be highly regrettable, but should it occur, the only solution would appear to lie in limiting the growth of imports

or even reducing them in absolute terms, in order to adjust them to exports. In such a contingency, the increase in real *per capita* income would be less than it might have been, and it is conceivable that it might decline if the phenomenon became acute.

In this connexion it is necessary to take into consideration one elementary fact. Europe has lost a large part of its investments in other parts of the world and, from the point of view of the availability of dollars, cannot be expected, even when the process of reconstruction is complete, to be in a position to supply dollars to Latin America. On the contrary, it will need to take great care to balance its own trade. Consequently, even if one individual country were able for a time to reduce its imports to Europe without perceptible loss in its exports to that area, it is obvious that Latin America as a whole could not do so.

In discussing the increase in capital, *per capita,* we have implicitly assumed that industrial establishments would be able to attain a satisfactory size, for which a minimum of production is required. What is this size in the Latin-American countries? The variety of conditions obtaining in the different countries makes it difficult to generalize in this case, as in others. Moreover, no systematic study of productivity and its relation to the optimum size of the establishment and the industry has yet been made in these countries. Depressive examples are quoted, however, of the sub-division of industry into an excessive number of inefficient undertakings within one country or of the multiplication of comparatively small enterprises in countries which, by combining their markets for a number of products, could reach a higher degree of productivity. The present division of markets, with its consequent inefficiency, constitutes another limitation of industrial growth, in this case one which could be overcome by the combined efforts of countries which, by reason of their geographical position and economic features, would be able to undertake it to their general advantage.

It was pointed out at the beginning of this section that there are two ways of increasing real income. One is through an increase in productivity and the other through a readjustment of income from primary production so as to lessen the disparity between it and income of the great industrial countries.

The second result can be achieved only in so far as the first is accomplished. As productivity and the average real income from industry increase in the Latin-American countries, wages in agriculture and primary production in general will have to rise, as they have in other countries.

The effect will be gradual and if there is not some relationship between all the respective increases in average income of the principal countries exporting primary products, unavoidable difficulties may arise in readjustments of the kind just mentioned, whether they be internal or international.

The possibility of gaining ground in this sphere depends also on the ability of Latin America to maintain the prices of primary products in the cyclical downswing, the point at which it has frequently lost all or a part of the share of the benefits of technical progress that the periphery usually receives in the upswing. There is room here for international economic co-operation.

VII. Bases for the discussion of an anti-cyclical policy in Latin America

The cycle is the typical form of economic growth under our present system, and, although it is a general phenomenon which must be explained by a single theory, it manifests itself in a different way at the cyclical centres and at the periphery.

Notwithstanding these differences, much has been written about the cycle at the centres, but very little regarding the periphery. The brief comments which follow are not an attempt to fill the gap, but an outline of some ideas on anti-cyclical policy which, if accepted in principle, could constitute a suitable basis for the discussion of the problem. If the discussion is not to take place on an abstract plane, the particular case of each country must be examined in order to determine whether its economic structure and existing conditions make those ideas practicable or whether other ways of dealing with the cycle must be found.

The firm intention of the United States Government to follow an anti-cyclical policy is well known. It does not seem advisable, however, to rely exclusively upon measures taken by the principal cyclical centre, since in the case of a contraction in that country, firm action on the part of the peripheral countries could be very opportune. The Latin-American countries should, therefore, prepare to play their part in the common task.

At the centres the policy resulting from this aim attempts to influence the volume of investments, which are considered the dynamic factor in economic fluctuations. This is not the case at the periphery. There exports are the dynamic factor, which is not surprising, since their fluctuations reflect those in income at the centres, which in turn are closely linked with investment.

It is not, of course, within the power of the periphery to regulate exports in the same way that the centres propose to regulate investments.[1]

Other means must therefore be sought of averting the more serious consequences of cycles on the internal activity of the Latin-American countries. In the first place, the idea that industrial development will in itself make them less vulnerable to these phenomena should be dismissed. For this to happen, exports would have to become a very small proportion

[1] This refers to the impossibility of the Latin-American countries changing the pattern of export fluctuations by their own actions, and not to the results that could be achieved through regulating export surpluses, to which reference is made at the end of this chapter.

of national income. In that case, a country would have already left the periphery and become a cyclical centre, and though it might thus have lessened its vulnerability to external influences, it would have developed those inherent characteristics of the system which give rise to the cyclical fluctuations of the centres.

We are rather of the opinion that industrial development will bring out the consequences of the cycle more clearly, by accentuating fluctuations in urban employment. In a country that is essentially agricultural, depressions manifest themselves more in the fall of rural income than in unemployment; indeed in many Latin-American countries during the great world depression, people who had previously gone to the cities to find work returned to the land. Unemployment was, so to speak, diluted. This cannot be expected when relatively large industrial masses are concentrated in the cities: in that case the cyclical unemployment problem would assume serious social complications.

Does this lead to the conclusion that, from the cyclical point of view, industrialization has this disadvantage? It might be so if economic activity were left free to operate under its own forces. If it is not, however, industrial development could be one of the most effective elements of an anti-cyclical policy.

Let us briefly examine the various possibilities: in one of them, perhaps the most wide-spread, an attempt is made to lessen or counteract the effects of export fluctuations on internal activity by means of a compensatory policy in which investments, chiefly in public works, are made to vary in adverse ratio to the fluctuation in exports. This policy demands certain conditions. During the cyclical upswing, tax revenue increases and the market is favourable to the sale of public bonds. Nevertheless, the State should not only abstain from using these additional resources to increase public investments, but should restrict them in proportion to the increase in private employment. Thus during the upswing resources would be accumulated in anticipation of bad times or used to repay bank credit extended during the preceding contraction. At the mere mention of these requirements the difficulty of fulfilling them is apparent. For the very reason that the Latin-American countries are in full process of development, their investment projects are always larger than can be carried out with the limited means available. To maintain that, when those means increase and the opportunity of carrying out such projects presents itself, the authorities instead of seizing it should accumulate resources for the future, which may be enjoyed by their successors, would mean making the success of anti-cyclical action depend on attitudes not always compatible with sound political interest.

There are yet other difficulties, among them the flexibility of plans. Investments must be alternately increased and restricted according to the cycle, and that is not an easy thing to do. Moreover, there would have to be a rapid transfer of people from the activities most affected by the

depression to those created by the new public investments. All this, if it does not lead to the exclusion of the possibility of anti-cyclical action, at least suggests the exploration of other means more suited to Latin America's individual characteristics.

It is important that internal activity should develop at a high level of employment, despite the cyclical movement of exports. The way in which that movement causes internal activity to rise and fall is well known. When exports increase, so does internal demand, and with it employment and income; the rise in income brings about in turn a rise in imports, which thus tend, although with some lag, to adjust themselves to exports. This is the way the cyclical upswing develops in Latin America. The opposite occurs in the downswing: the fall of exports brings about a drop in income and employment, with a consequent reduction of imports.

Let us now assume that in the course of these phenomena, internal activity has reached its lowest point. Employment has fallen with a corresponding reduction of income from a maximum of, let us say, 10,000 to a minimum of 7,500. Of this 7,500, twenty per cent, or 1,500, is spent on imports required in addition to local production to satisfy the current needs of the population, and the very low level to which exports were reduced barely suffices to pay for these imports.

If, in order to increase employment and income to a maximum, a policy of expansion similar to that recommended in the great centres were followed, there would be an immediate increase in imports, providing the coefficient had not changed. Thus when income reached 10,000, imports would be at least 2,000, and if exports were maintained at a level close to 1,500, there would ensue a disequilibrium which would reduce monetary reserves to a very small amount in a relatively short time.

It should be pointed out incidentally that similar difficulties are not likely to occur at the centre during the downswing, since that is precisely when they receive the inflow of gold from the peripheral countries.

Without exceptional resources, it would not seem possible, therefore, to develop in these countries a policy of expansion tending to increase employment, and at the same time not reduce the import coefficient.

The possibility of doing so is limited by obstacles which vary in importance from one country to another. Let us assume, for the sake of simplifying the argument, that they have been overcome and that the coefficient has gradually been reduced from 20 to 15 per cent through tariff changes. This has enabled employment and income to expand without an increase in imports above the minimum of 1,500, the level at which exports are also maintained; in other words maximum employment has been achieved without disturbing the equilibrium of the balance of payments.

Thus, owing to the reduction of the coefficient, the current needs of the population at this maximum level of employment can now be satisfied

with 500 less in imports. The problem has therefore been that of producing the difference internally, whether they were finished consumer goods or the raw materials essential to their manufacture.

Not all consumption, however, can be satisfied by articles of immediate consumption or of comparatively short duration. As pointed out elsewhere, technical progress in the great industrial countries has steadily created new needs for durable consumer goods which must be imported. These goods become indispensable as the standard of living rises. This does not mean, however, that the importation of such articles cannot be drastically reduced when the fall in exports hardly allows payment for essential imports. For the very reason that the goods are durable, it would seem possible to restrict importation of them to the extent required by the intensity of the downswing, if they have been freely imported in the preceding upswing.

The same applies to capital goods. If it has been possible to meet requirements during the upswing, it will be possible to restrict temporarily their import during the downswing. In this connexion, it should be taken into account that with the reduction of the coefficient for articles and materials intended directly or indirectly to satisfy current needs, there will be a greater margin than before for the importation of both durable capital goods and durable consumer goods.

Finally, there are non-essential goods satisfying current needs, which are imported in comparatively large quantities in times of prosperity; it is obvious that when foreign exchange is scarce importation of these can be reduced without serious consequences.

In short, for the purposes of this policy, imports are divided into two categories. One covers those that cannot be deferred, and includes the articles and materials indispensable for achieving maximum employment with a minimum of exports and at the same time ensuring the satisfaction of current needs. The other includes imports of durable consumer or capital goods which are by nature deferable, as well as unessential goods for current consumption.

Let us now continue with our example. The policy adopted had succeeded in bringing about maximum employment, but meanwhile exports had again increased under the influence of a new upswing. At the same time, the demand of primary products which had also fallen to its cyclical minimum, rose again in proportion to the rise in income caused by the increase in the value of exports. It is evident that where there is maximum employment, this increase in demand will inevitably cause a corresponding increase in imports. Prices will also rise, with a consequent increase in the profits of entrepreneurs, which in turn increases their demand and, through it, imports.

Consequently the increase in income that ordinarily results from a rise in exports above the cyclical minimum will soon be transformed, in one way or another, into an increase in imports, without affecting the level of internal employment.

It must be remembered that the readjustment of the coefficient does not mean a reduction in imports. They will be of the same magnitude whether or not this anti-cyclical policy is followed, since they depend ultimately on exports and foreign investments. To reach the goal desired, it is only necessary to alter their composition.

In other words, this change is as follows. When exports are at the cyclical minimum, a peripheral country can pay for only a comparatively small quantity of imports. That quantity is not sufficient to cover the imports required to maintain maximum employment. Hence it is necessary to change the composition of imports and, with it, the structure and volume of internal production, in order to satisfy the current needs of the population while maintaining maximum employment.

While exports remain at their minimum level, only goods essential for maintaining employment and current consumption can be imported. When, however, exports again increase with the upswing, the time will have come for the importation of the additional goods necessitated by the increase in demand.

Thus while the imports essential to the satisfaction of the current needs of the population will follow the relatively slow rate of the organic growth of the country, deferable imports will remain subject to the fluctuation in exports.

When it was explained above that a reduction in the coefficient of imports for current consumption was indispensable for the carrying out of an anti-cyclical policy, reference was made to the obstacles which would have to be overcome. These obstacles are of various types.

In the first place, the substitution of internal production for imports usually requires the raising of tariffs, owing to the higher cost of internal production. From this point of view, there would be a loss in real income, but on the other hand, the loss in income resulting from cyclical fluctuations in employment is usually very great. It is very probable that in most cases the collective gain from employment stability is much greater than the loss resulting from the higher cost of internal production. It is conceivable, however, that the precariousness of natural resources and the inefficiency of workers or management might be such that the loss through increased costs would absorb an excessively large part of the increase in real income gained through greater employment. The seriousness of this difficulty cannot be denied.

At the same time, the substitution of internal production for imports requires the importation of capital goods, and consequently the necessity of saving during the process of reducing the coefficient. Even if saving could be achieved internally, to import the capital goods it would be necessary to reduce still further the coefficient of imports for current consumption, thus bringing about a further rise in the cost of living. Therein lies the second obstacle, one which could doubtless be partly removed

with the co-operation of international financial institutions, which would thus be able to show that their anti-cyclical measures, while aiding the peripheral countries, also help to maintain the demand for capital goods at the centres.

Finally, an anti-cyclical policy of this kind might require transfers of productive factors that are not always easily carried out. However, as explained in another chapter, these difficulties could be lessened to a large extent by the increase of the population of working age and by the better utilization of the ill-employed.

In Latin America, the lowest point on the curve of exports and foreign investments has been rising in succeeding cycles. This does not mean, however, that they may not fall to a level lower than in the preceding cycle; the phenomenon is unusual, but has been known to occur, as, for instance, during the great world depression. If it should happen again, a high level of employment could be maintained only to the extent to which monetary reserves were sufficient to cover the excess of essential import over minimum exports or in so far as the international lending agencies were able to achieve their anti-cyclical purpose.[2]

The need for reducing imports of durable goods during the cyclical downswing has already been pointed out. Is exchange control indispensable to achieve this? As has been seen, the increase in demand for such goods is chiefly the result of new income from increased exports; hence if there is no undue increase in that demand as a result of credit expansion, there will be no need for restrictions, unless there should be a sharp drop in export prices in the cyclical downswing. Restrictive measures would be necessary only if the expansion were very great, or if minimum exports fell below the level of essential imports and there were no extraordinary resources to pay for them.

In such a case, the alternatives are clear: either to reduce even more the coefficient for essential imports, the increase in protective tariffs implied placing an additional burden on the consumers, or deliberately to restrict imports of deferable articles by means of exchange control.

It is easy to picture a country where a marked propensity to import non-essential articles might be incompatible with the high level of imports of capital goods needed for intensive economic development. Exchange control could then be an effective instrument of selection, without precluding other measures.

For such special cases, one can envisage simple measures of control by which the distribution of import permits would be left to the free play of supply and demand, within the limits of the amount of exchange to be made available for such imports.

[2] In this connexion, see the remarks of Dr. Hermann Max in *Significado de un Plan Marshall para América Latina.*

On the other hand, it is obvious that if a country were to embark on a very easy credit policy, it would be compelled to choose between devaluation or a system of exchange control which, while masking that devaluation, diverts it with an inflationary influence towards internal activity. An effective instrument of anti-cyclical policy would then become an instrument of inflationary policy. Actually, all measures of monetary policy may equally well be put to good or bad use. There would not even be the excuse of unemployment since, as maximum employment would have been already been achieved, there would be no valid reason to continue the credit expansion.

Mention has already been made of the extreme case in which the cyclical minimum of exports is insufficient to cover essential imports. This is where monetary reserves can fulfil their specific function. It is therefore an appropriate point at which to examine the matter.

Reserves increase in the upswing and, in the downswing, lose a large part of that increase; the greater the previous credit expansion, the greater the loss incurred. This is easily comprehensible if it is remembered that in the peripheral countries imports generally lag behind exports. This, and the similar movement of other items in the balance of payments, causes receipts to exceed payments during the upswing, with a consequent inflow of gold and foreign exchange, while, in the downsing, the opposite occurs.

The theoretical explanation of this interesting process can be briefly recalled. The gold and foreign exchange that flowed in during the upswing tend to flow out again through the circulatory movement of the corresponding income. The foreign exchange that flows in as a result of an increase in exports, for instance, is closely related to an equivalent increase in income; this increase in income circulates internally and is transformed into other increases in income; but in each stage of this circulatory process part of the increase becomes an additional demand for imports, so that the original amount is progressively reduced. Thus the inflowing foreign exchange tends to flow out again. The time lag before it flows out depends, among other things, on the magnitude of the import coefficient and other liability items.

Other things being equal, the higher this coefficient, the sooner will exchange flow out.

It should not be surprising that the outflow of foreign exchange from the Latin-American countries is imperceptible during the cyclical upswings, since the new exchange then flowing in exceeds, in the international accounts of a country, the exchange that flows out, and there is a net gold balance in favour of the country. In the downswing, when exports and other asset items decrease, the outflowing foreign exchange exceeds the inflowing, and monetary reserves thus lose part of the gold gained before.

At the end of each cycle there is thus a net increase in gold which represents the share of the country in the world distribution of new monetary metal production. The net increase is comparatively small and depends in the long run on the rate of economic growth of the country and on its coefficient of imports and other liability items in relation to the rest of the world.

If the coefficients do not change, the country which has a higher rate of increase than most will tend to lose a part of the net increase in gold which it would otherwise have had; the more marked the difference in the rates of growth throughout cyclical fluctuations, the greater will be the loss in the net increase of gold.

It could well happen that the gold added, in course of time, to the monetary reserves of a country would not be sufficient to offset the consequences of a reduction in exports during an unusually deep depression. Clearly a reduction in the total import coefficient would help to retain a greater amount of gold in periods of prosperity, and the country would be better able to face such an eventuality.

Additional monetary reserves could also be built up by means of savings; in so far as savings are not invested, a part of income in circulation is not transformed into imports and consequently does not give rise to an outflow of gold. The quantity of gold retained is equal to that of savings. This could be achieved, for instance, if the central bank were to issue bonds during the upswing and cancel the corresponding amount of money, which would again be put into circulation in the downswing; there would be an additional reserve equivalent to the money cancelled which, together with the existing reserves and the share in the world distribution of gold, could relieve monetary pressure if minimum exports should not be sufficient to cover essential imports.

We realize that the building up of additional reserves by means of savings is not a very attractive solution to countries that need to import large quantities of capital goods. It is clear, however, that if a country were able to obtain international credit during a period of acute depression, it could use more gold during the upswing to import capital goods instead of retaining it as envisaged above. Such a possibility is, in fact, conceivable if a general anti-cyclical programme could be drawn up for the periphery whereby a country which had followed a sound policy could rely upon sufficient co-operation on the part of international institutions during the downswing.

It is very understandable that while an inflationary process was developing at the principal centre, it was not considered advisable to aggravate it by granting international credit in excess of that required for the urgent needs of Europe. If, however, there were to be a contraction, the case would be different, and it would be the right moment to adopt a general anti-cyclical policy without the contradictions that would result from unilateral action by each one of the Latin-American countries.

International action need not be limited to the field of credit. There are other effective ways of combating depression in the peripheral countries. There has been much discussion of the possibility of purchasing the surpluses of primary production. It is well known that in the downswing agricultural production falls far less than that of industry. It is in the interest of both the centres and the periphery that it should not decline very much, since that would delay the recovery of the centres. It follows that a judicious policy of purchasing surpluses could be highly beneficial; the reduction in imports of primary producer countries would be less, in so far as the cyclical fall in exports could be checked and, consequently, the reduction of demand in the industrial countries would also be smaller.

This regulatory measure would have another advantage. The prevention of an unduly large drop in the prices of primary products through such purchases would help to keep the relation between those of primary and finished products from continually turning against the peripheral countries in the way described earlier.

The aforementioned tendency of agricultural production to decline far less than that of industry, or to decline hardly at all, was taken into consideration earlier, when the bases for a discussion of an anti-cyclical policy were outlined. It was then assumed that the reduction of exports would cause a decline in income in primary production, but no reference was made to the possibility of rural unemployment. The downswing is reflected in a drop in prices rather than in a contraction of production, but as rural profits fall with the prices, so likewise do investments in agriculture, thus causing a certain amount of unemployment.

Though, for the reasons given at the beginning of this chapter, a general compensatory policy is not deemed practicable, this does not mean that there is no need for partial compensatory measures. Even with the effective application of an anti-cyclical policy fluctuation in some types of investments is inevitable. In fact, we have seen that an increase in the profits of entrepreneurs causes an increase in their imports of capital goods. The new equipment, however, calls for the construction of buildings and other improvements that absorb man-power during the upswing and releases it in the downswing, just as happens in the case of rural investments.

This is not an unsurmountable obstacle. One of the specific advantages of not being obliged to follow a compensatory policy of public works and general investment is that of being able to plan steady development in accordance with the growing needs of the country and the amount of savings that can be used to satisfy them. The total amount of construction can thus increase from year to year without the acute fluctuations entailed by a compensatory policy. Partial readjustments would fit into this progressive development very well. For instance, mortgage loans for

private construction could be reduced during the upswing, in order to make available man-power for industrial construction, and during the downswing additional loans could be granted for construction and rural investments in general.

The ideas expressed in this chapter are far from constituting a programme of anti-cyclical policy. They are intended only to present the main aspects of the problem and to arouse discussion, while at the same time pointing out certain differences between cyclical behaviour at the centres and at the periphery which oblige the Latin-American countries to work out their own programme.

Moreover, the exposition of the principal problems relating to the economic development of Latin America would not have been complete without a consideration of anti-cyclical policy. It is an indispensable complement of a long-term economic development policy. As mentioned before, industry will bring out the vulnerability of the periphery to the fluctuations of the centre. It is not enough to increase productivity and thus absorb unemployed or ill-employed factors. Once productive employment has been achieved, steps must be taken to prevent a return of unemployment as a result of cyclical fluctuations.

The two policies are compatible, however, not only as regards their ultimate aim, but also the means of achieving them. Both require a readjustment of the import coefficient. The anti-cyclical policy calls for it so that a country may continue to satisfy its current needs and to maintain maximum employment in spite of fluctuating exports. The industries and activities which satisfy those needs are precisely those which the Latin-American countries can establish with least difficulty, thanks to a market which expands as the rise in productivity increases consumption. If a country could achieve this objective, it would be in a position to endure bad times without detriment to current consumption and employment. It is not necessary for this purpose to force the creation of capital goods industries. If it could be accomplished by a high level of industrial development, technical skill and the accumulation of savings, it would certainly be an encouraging proof of maturity. There is no sound economic reason for setting up capital goods industries, however, since there is still ample room for increasing the productivity of those producing for current consumption.

From the standpoint of economic development, the maximum rise in the standard of living depends on productivity and this in turn depends to a great extent on the most efficient machines. At the same time, it is in durable consumer goods that technical progress continually offers new or improved articles. It would seem advisable, therefore, to import such articles as can be paid for by means of exports or, in the case of capital goods, by foreign investments, within a general programme of economic development.

Moreover, from the anti-cyclical viewpoint, the consequences of export fluctuations could be diverted to fall entirely upon the importation of these imports.

All these are general considerations, which, by their very nature, cannot be applied to particular cases. A country might undertake the establishment of durable goods industries during the initial stage of its industrial development for special reasons, which would have to be carefully analysed.

Here, as in many other cases, our knowledge of the economic structure of the Latin-American countries, their cyclical form of growth and their possibilities is limited. If a scientifically impartial investigation of such questions could be carried out and the training encouraged of economists capable of grasping new economic phenomena, foreseeing the problems involved and co-operating in the search for solutions, a service of incalculable value would be rendered to the economic development of Latin America.